The Economist

FEBRUARY 7TH–13TH 2009 www.economist.com

Obama slips up

Japan's ailing electronics firms

The dark horse in Israel's election

Charles Darwin, still evolving

Where to get divorced

THE RETURN OF ECONOMIC NATIONALISM

Print edition February 7th 2009

The return of economic nationalism

A spectre is rising. To bury it again, Barack Obama needs to take the lead: leader



Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

ng Kim

Correction: Cambodia

Middle East & Africa

Israel
Politics not quite as usual

Voting in Iraq
God takes a back seat

Iran's 30-year-old republic
Defiant, and doubtful

Ethiopia
A row over human rights

Turmoil in Madagascar
I'm king of the...oops

Kenya
Double trouble

Europe

The euro area
A tricky balancing act

Food in France
Sandwich courses

The Irish economy
Reykjavik-on-Liffey

Turkey's prime minister
Temper tantrums

Spain's rail ambitions
Ave Madrid

Amsterdam's troubled metro
A big dig

Charlemagne
Single-market blues

Britain

Industrial action
Discontents, wintry and otherwise

Torture and the law
That curious relationship

Monetary policy
Breaking the rule book

Snowbound Britain
White-out

Jaguar Land Rover
Cash-hungry

Price-comparison websites
Caveat surfer

Britain's children
What ails them?

Bagehot
Apologise, Gordon

Articles flagged with this icon are printed only in the British edition of *The Economist*

International

The World Social Forum
Dear capitalists, admit you got it wrong

Cyber-hedonism
Virtual pleasures

Correction: The YSL / Pierre Bergé sale

Obituary

Anastasia Baburova

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

The Economist poll of forecasters, February averages

Trade, exchange rates, budget balances and interest rates

Markets

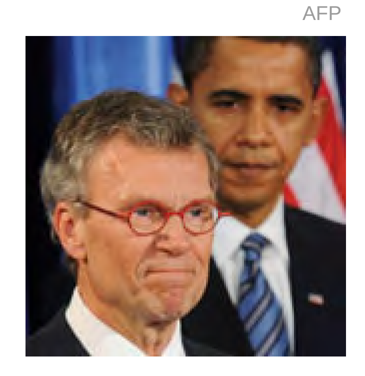
Open budget index

Economist.com WORLD

Politics this week

Feb 5th 2009
From The Economist print edition

AFP



Barack Obama admitted that he “screwed up” in nominating **Tom Daschle** for health secretary. Mr Daschle withdrew his name after it emerged that he had failed to keep his taxes in proper order and had made late payments. His departure is a blow for the new administration’s health policy; Mr Daschle, a former senator, was to have overseen negotiations with Congress over reforming the health system. See article

The Democrats were also embarrassed when **Nancy Killefer** said she would no longer seek the job of the federal government’s first “performance tsar”. She had failed to pay taxes on a domestic employee and is the third of Mr Obama’s nominees to have problems with the tax code. See article

The Senate modified the **“Buy American”** part of the stimulus package (which America’s trade partners say is protectionist and could lead to a trade war) by inserting a clause promising to abide by America’s international obligations.

Mr Obama chose a Republican, **Judd Gregg**, as commerce secretary. Mr Gregg is a senator from New Hampshire and agreed to take the job only after assurances that the state’s Democratic governor would pick a Republican to replace him. The Democrats are tantalisingly close to a 60-seat filibuster-proof majority.

Pat Quinn completed his first week as the new **governor of Illinois**. Rod Blagojevich was removed from office by the state Senate on January 29th after his impeachment.

Partners in peace

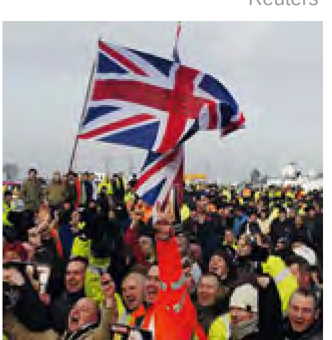
Germany and **France** announced that German troops would be stationed on French soil for the first time since the second world war. A German battalion is likely to be based in Alsace-Lorraine, a region repeatedly fought over by the two countries in the past.

The pope ordered a traditionalist bishop, Richard Williamson, whom he had recently readmitted to the Catholic church, to recant on his denials of the Holocaust. The about-turn by the pope, who is German, came after an intervention by the German chancellor, Angela Merkel.

Amid a spate of bad economic news in Europe, **Spain** reported a sharp rise in unemployment to 14.4% and **Ireland** a jump to 9.2%, in both cases the highest rates for over a decade. See article

The **Russian rouble** came under fresh attack after the central bank tried to establish a floor for it. It has lost a third of its value against the dollar since August. The deputy prime minister, Igor Shuvalov, said Russia would not run a budget deficit.

Reuters



Britain was hit by a series of unofficial wildcat strikes over the use of foreign workers. The strikers' main objection is to the effects of a European Union directive which, they say, makes it easier for firms to employ foreign workers. Gordon Brown’s promise of “British jobs for British workers” returned to haunt him. See article

Stimulating stuff

Faced with a rapidly cooling economy, **Brazil's** government announced plans to increase spending on infrastructure this year by 28% and to set up a 500m reais ($220m) fund to insure mortgages issued to poorer families.

An armed group damaged and defaced with anti-Semitic slogans the main synagogue in Caracas, **Venezuela's** capital. Jewish leaders blamed President Hugo Chávez for creating a climate of anti-Semitism after he broke off relations with Israel over its invasion of Gaza. The government said that the attack was the work of opponents seeking to discredit the president ahead of a referendum later this month to abolish term limits.

Colombia's FARC guerrillas released five hostages, including a former provincial governor held captive for more than seven years. The FARC are believed to continue to hold several hundred hostages for ransom.

Endangered Tigers

Fierce fighting continued in northern **Sri Lanka** as President Mahinda Rajapaksa predicted that the final defeat of the rebel Liberation Tigers of Tamil Eelam was imminent. America, Japan, the European Union and others called on the Tigers to surrender. Some 250,000 civilians were trapped by the fighting; the government accused the Tigers of using them as human shields. The only hospital in Tiger-controlled territory was repeatedly shelled and bombed, though the government denied it was responsible. See article

The government of **Kyrgyzstan** asked parliament to approve the closure of an important American air base, Manas, near the capital, Bishkek. The only American base in Central Asia, Manas plays an important role in supporting American and NATO troops in Afghanistan.

A suicide-bomber in Tirin Kot, in Uruzgan province in southern **Afghanistan**, blew himself up in a police station, killing more than 20 policemen. A Taliban spokesman claimed responsibility on behalf of the group.

Ibrahim Gambari, the United Nations special envoy to **Myanmar**, paid his first visit to the country since August. This time he managed to meet Aung San Suu Kyi, the detained opposition leader. But Than Shwe, head of the ruling junta, was unavailable. See article

North Korea said it was scrapping agreements made with South Korea to prevent hostilities. There were fears of a clash over the maritime border, and reports that the North was preparing to test-fire its longest-range missile. See article

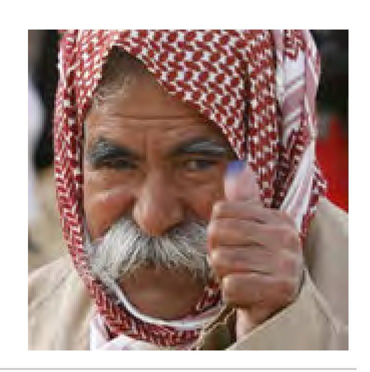
Representative government

Morgan Tsvangirai, the leader of **Zimbabwe's** main opposition party, the Movement for Democratic Change, agreed to enter into a power-sharing government with President Robert Mugabe (some issues are still to be resolved). African countries urged everyone to support the new government; Britain and America vowed to maintain their sanctions until they see evidence that Mr Mugabe really has relinquished some power to Mr Tsvangirai. See article

Iran blasted a satellite into orbit. Carried on a Safir-2 rocket, the launch came as the country celebrates the 30th anniversary of the Islamic revolution. America viewed the launch with “great concern”, fearing it could lead to the development of longer-range ballistic missiles. See article

Elections were held in 14 of **Iraq's** 18 provinces. In contrast to 2005, they passed off relatively peacefully. This was hailed as a great success by many, although, with security now so much better than it was, voter turnout was unexpectedly low. See article

Reuters



Business this week

Feb 5th 2009
From The Economist print edition

Tim Geithner, America's treasury secretary, declared that **executive pay** at companies that receive "exceptional assistance" from the government will be capped at $500,000 and that any additional compensation would have to be made in restricted stock that won't vest until the public money is repaid. The policy, which does not apply to companies that have already received aid, comes as politicians step up their criticism of what they describe as executive excess at banks that have chalked up massive losses. See article

Getting the message?

Wells Fargo scrapped plans to hold a conference in Las Vegas, "in light of the current environment". The bank received $25 billion in federal aid last year. **Goldman Sachs** also said that "in light of the current environment" it was rescheduling a hedge-fund managers' conference that had been due to take place in March at a 300-acre luxury resort in Florida.

The **Bank of England** reduced interest rates by half a percentage point, to 1%. See article

Big oil companies reported mixed earnings. Despite a 33% fall in its net income in the fourth quarter compared with a year earlier, **Exxon Mobil** turned an annual profit of $45.2 billion in 2008, the biggest-ever for an American company. **Chevron's** quarterly profit of $4.9 billion was similar to a year ago. And **BP** said its replacement-cost profit was $25.6 billion for the year, though it made a net loss in the last quarter.

More **Japanese electronics companies** announced swingeing job cuts. Panasonic shed 15,000 employees, NEC slashed its workforce by 20,000 and Hitachi said 7,000 jobs would go. The companies all posted big losses for the fourth quarter, as consumers reined in their spending and the yen strengthened, hurting Japanese exports. See article

Dow Chemical's troubles continued. America's biggest chemical company made a quarterly net loss of $1.6 billion as demand for its products fell among manufacturers. It was dealt an additional blow late last year when Kuwait pulled out of a multibillion-dollar investment venture, which in turn caused Dow to delay its takeover of Rohm & Haas. That company is suing Dow to complete the deal.

Roche launched a new bid for the 44% of shares it doesn't already own in **Genentech**, and took it directly to the biotechnology company's shareholders. A committee of independent directors at Genentech rejected a proposal from Roche last August.

Motorola released dismal quarterly earnings. The company suspended its dividend and said its chief financial officer was leaving. Motorola's share of the global mobile-phone market has fallen to 6.5%, from 23% just a few years ago.

Shareholders approved a plan to buy out **PCCW**, Hong Kong's main telecoms company. Richard Li, PCCW's chairman, has offered to take the company private following a slump in its share price. Some investors say the price should be higher. PCCW had to ask regulators to suspend trading in its shares this week amid allegations that attempts had been made to rig the outcome of the vote.

Rio calls in Beijing

Rio Tinto confirmed that it was talking to **Chinalco** about the possibility of the state-owned Chinese aluminium producer making an investment in the company. The Anglo-Australian mining giant has accumulated debt of some $40 billion. See article

January was the worst month for **car sales** in the United States for decades. Almost 657,000 cars and

light trucks were sold; more vehicles were bought in China than America for the first time. General Motors' sales plunged by 49% compared with January 2008, Ford's by 40% and Chrysler's by 55%. Toyota, the world's biggest carmaker, saw its American sales fall by 32%.

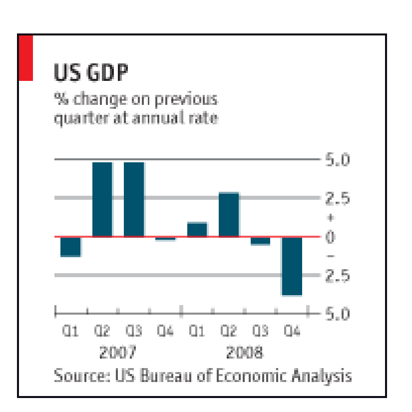
Meanwhile, America's **car-parts suppliers** asked the Treasury for $25.5 billion in state aid, which includes creating a fund that would reduce the time it takes carmakers to pay for parts.

Keep your motor running

Warren Buffett bought half of a $600m debt offering from **Harley-Davidson**. The motorcycle-maker is using the funds to shore up its loss making financing arm. The notes pay 15% annual interest to Mr Buffett, more than twice the rate of a standard corporate bond.

Mr Buffett also agreed to invest SFr3 billion ($2.6 billion) in **Swiss Re**. The reinsurer is boosting its capital after booking massive write-downs and making an annual net loss.

America's **GDP** decreased at an annual rate of 3.8% in the fourth quarter of 2008, according to the official first estimate. Had it not been for a sharp rise in the quarter of inventories, economic output would have fallen by just over 5%.



KAL's cartoon

Feb 5th 2009
From The Economist print edition

Illustration by KAL



The world economy

The return of economic nationalism

Feb 5th 2009
From The Economist print edition

A spectre is rising. To bury it again, Barack Obama needs to take the lead

Illustration by Jon Berkeley



MANAGING a crisis as complex as this one has so far called for nuance and pragmatism rather than stridency and principle. Should governments prop up credit markets by offering guarantees or creating bad banks? Probably both. What package of fiscal stimulus would be most effective? It varies from one country to the next. Should banks be nationalised? Yes, in some circumstances. Only the foolish and the partisan have rejected (or embraced) any solutions categorically.

But the re-emergence of a spectre from the darkest period of modern history argues for a different, indeed strident, response. Economic nationalism—the urge to keep jobs and capital at home—is both turning the economic crisis into a political one and threatening the world with depression. If it is not buried again forthwith, the consequences will be dire.

Devil take the hindmost

Trade encourages specialisation, which brings prosperity; global capital markets, for all their problems, allocate money more efficiently than local ones; economic co-operation encourages confidence and enhances security. Yet despite its obvious benefits, the globalised economy is under threat.

Congress is arguing about a clause in the $800 billion-plus stimulus package that in its most extreme form would press for the use of American materials in public works. Earlier, Tim Geithner, the new treasury secretary, accused China of "manipulating" its currency, prompting snarls from Beijing. Around the world, carmakers have lobbied for support (see article), and some have got it. A host of industries, in countries from India to Ecuador, want help from their governments.

The grip of nationalism is tightest in banking (see article). In France and Britain, politicians pouring taxpayers' money into ailing banks are demanding that the cash be lent at home. Since banks are reducing overall lending, that means repatriating cash. Regulators are thinking nationally too. Switzerland now favours domestic loans by ignoring them in one measure of the capital its banks need to hold; foreign loans count in full.

Governments protect goods and capital largely in order to protect jobs. Around the world, workers are demanding help from the state with increasing panic. British strikers, quoting Gordon Brown's ill-chosen words back at him, are demanding that he provide "British jobs for British workers" (see article). In France more than 1m people stayed away from work on January 29th, marching for jobs and wages. In

Greece police used tear gas to control farmers calling for even more subsidies.

Three arguments are raised in defence of economic nationalism: that it is justified commercially; that it is justified politically; and that it won't get very far. On the first point, some damaged banks may feel safer retreating to their home markets, where they understand the risks and benefit from scale; but that is a trend which governments should seek to counteract, not to encourage. On the second point, it is reasonable for politicians to want to spend taxpayers' money at home—so long as the costs of doing so are not unacceptably high.

In this case, however, the costs could be enormous. For the third argument—that protectionism will not get very far—is dangerously complacent. True, everybody sensible scoffs at Reed Smoot and Willis Hawley, the lawmakers who in 1930 exacerbated the Depression by raising American tariffs. But reasonable people opposed them at the time, and failed to stop them: 1,028 economists petitioned against their bill. Certainly, global supply-chains are more complex and harder to pick apart than in those days. But when nationalism is on the march, even commercial logic gets trampled underfoot.

The links that bind countries' economies together are under strain. World trade may well shrink this year for the first time since 1982. Net private-sector capital flows to the emerging markets are likely to fall to $165 billion, from a peak of $929 billion in 2007. Even if there were no policies to undermine it, globalisation is suffering its biggest reversal in the modern era.

Politicians know that, with support for open markets low and falling, they must be seen to do something; and policies designed to put something right at home can inadvertently eat away at the global system. An attempt to prop up Ireland's banks last year sucked deposits out of Britain's. American plans to monitor domestic bank lending month by month will encourage lending at home rather than abroad. As countries try to save themselves they endanger each other.

The big question is what America will do. At some moments in this crisis it has shown the way—by agreeing to supply dollars to countries that needed them, and by guaranteeing the contracts of European banks when it rescued a big insurer. But the "Buy American" provisions in the stimulus bill are alarmingly nationalistic. They would not even boost American employment in the short run, because—just as with Smoot-Hawley—the inevitable retaliation would destroy more jobs at exporting firms. And the political consequences would be far worse than the economic ones. They would send a disastrous signal to the rest of the world: the champion of open markets is going it alone.

A time to act

Barack Obama says that he doesn't like "Buy American" (and the provisions have been softened in the Senate's version of the stimulus plan). That's good—but not enough. Mr Obama should veto the entire package unless they are removed. And he must go further, by championing three principles.

The first principle is co-ordination—especially in rescue packages, like the one that helped the rich world's banks last year. Countries' stimulus plans should be built around common principles, even if they differ in the details. Co-ordination is good economics, as well as good politics: combined plans are also more economically potent than national ones.

The second principle is forbearance. Each nation's stimulus plan should embrace open markets, even if some foreigners will benefit. Similarly, financial regulators should leave the re-regulation of cross-border banking until later, at an international level, rather than beggaring their neighbours by grabbing scarce capital, setting targets for domestic lending and drawing up rules with long-term consequences now.

The third principle is multilateralism. The IMF and the development banks should help to meet emerging markets' shortfall in capital. They need the structure and the resources to do so. The World Trade Organisation can help to shore up the trading system if its members pledge to complete the Doha round of trade talks and make good on their promise at last year's G20 meeting to put aside the arsenal of trade sanctions.

When economic conflict seems more likely than ever, what can persuade countries to give up their trade weapons? American leadership is the only chance. The international economic system depends upon a guarantor, prepared to back it during crises. In the 19th century Britain played that part. Nobody did between the wars, and the consequences were disastrous. Partly because of that mistake, America bravely sponsored a new economic order after the second world war.

Once again, the task of saving the world economy falls to America. Mr Obama must show that he is ready for it. If he is, he should kill any “Buy American” provisions. If he isn’t, America and the rest of the world are in deep trouble.

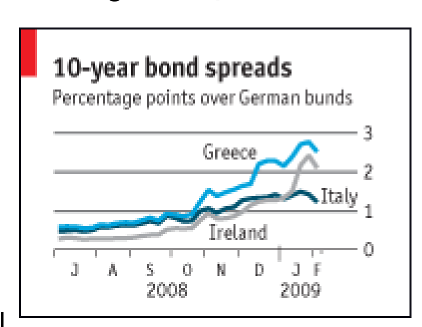
Economist.com


The euro

High tensions

Feb 5th 2009
From The Economist print edition

The danger of a euro crisis is increasing; it may prompt more political integration, not less



FOR all the faults they have displayed in recent years, financial markets still provide useful signals. Right now, they are indicating danger for Europe's single currency, the euro.

The signalling is coming not from the foreign-exchange market (the euro has climbed back from its October low against the dollar) but from the bond markets. Spreads on the ten-year government debt of Greece, Ireland, Italy, Portugal and Spain over that of Germany have widened sharply. Rating agencies are paying particularly close attention to the fiscal positions of the profligate five: Standard & Poor's has downgraded three of them and put another on credit watch.

The recession in the early 1990s saw a near-continual series of currency crises within Europe's exchange-rate mechanism. One motive for creating the euro was precisely to avert such evils in future. Indeed, some of those fretting about the troubles of the euro area's weaker economies are publicly drawing comfort because they have at least been spared pressure from the foreign-exchange market.

Yet pressure has to go somewhere. And in these countries it is emerging in the form of lost competitiveness, gaping current-account and budget deficits, and the markets' fears for national creditworthiness—with the effects being felt in falling GDP and rising unemployment.

To a large extent these five countries could be chided for reaping what they have sown. In the 1990s many made strenuous efforts, through fiscal tightening, wage restraint and product- and labour-market reforms, to qualify under the Maastricht treaty's criteria for euro membership. But once they passed the test they relaxed, beguiled by the notion that membership of the single currency would of itself solve their problems. At the same time they enjoyed the benefits of a boom brought on in part by the euro's lower interest rates. Yet the logic of their situation argued for exactly the opposite course. Once in the euro, and deprived of the chance to devalue again, they should have pursued more vigorous reforms at home to make their economies better able to compete with Germany's; and they should have pulled the fiscal reins even tighter to offset the euro's easier monetary policy.

Now that Europe (including Germany) is again in deep recession, this logic is hitting home. In Spain and Ireland property bubbles that were inflated in part by the switch to low euro interest rates have burst spectacularly. In Greece, Italy and Portugal a steady loss of wage and price competitiveness is eroding growth. In all five countries, as budget deficits grow, worries that public finances may get onto an unsustainable path are rising (see article). The bond markets are especially concerned about Greece and Ireland; but fears are growing even over such big countries as Italy (where public debt stands at over 100% of GDP) and Spain.

No exit strategy

Anglo-Saxon sceptics about Europe's single currency gleefully predict that these strains will blow the euro apart, just as they did the exchange-rate mechanism in the early 1990s. Yet even if some countries now have a twinge of regret over joining the euro, they know that the pain would get worse still if they left. Quite apart from the huge technical problems of reintroducing a national currency, quitting the euro would surely entail default on euro-denominated debts, and could also put a country's membership of the European Union at risk.

Yet if leaving the euro is unthinkable, the risk of default by a country that stays in has clearly gone up.

As more countries from central and eastern Europe join, that danger is likely to rise further. This suggests that it would be sensible to draw up contingency plans for how the rest of the euro area should best respond to a threatened or actual default.

The rules of the single currency expressly forbid any bail-out of one country by the centre or by other countries. The Germans, ever fearful that they may be asked to pick up the bill for the profligacy of others, are already squashing any talk of issuing joint euro-area bonds to relieve some of the pressure on national governments. Yet as the euro area's biggest economy and biggest exporter, Germany would suffer more than most from any member's default. So it has a huge stake in making sure it does not reach that point.

That need not imply a straightforward bail-out. But it does suggest the euro area might need an equivalent of the International Monetary Fund's rescue packages. It would imply both a bigger role for the centre and more intrusive monitoring of euro members' budgets. Far from fulfilling the eurosceptics' dream of kiboshing the entire European project, a crisis could thus lead to even deeper political integration. That is a guess. But some form of euro drama looks ever more likely—and it would be better if governments started preparing for it now.

Venezuela

Ten mostly wasted years

Feb 5th 2009
From The Economist print edition

Even if he wins his latest referendum Hugo Chávez is diminished. He may soon be desperate

AFP



THIS ought to be a time of triumph for Hugo Chávez, Venezuela's self-proclaimed "21st-century socialist". As he marks ten years in power this week, what he calls "savage capitalism" is wounded and seemingly at bay while his would-be nemesis, George Bush, has departed the White House. On February 15th Mr Chávez hopes to win a referendum that would remove all political term limits, a first step to realising his modest ambition to remain in power until at least 2030. In fact, neither Venezuelans nor their leader have much to celebrate.

Mr Chávez's supporters—and it has to be recognised that these have until recently numbered around 60% of Venezuelan voters—claim that he has transformed his country for the better by empowering the poorer and darker-skinned among its citizens. Social "missions", some of them staffed by Cubans, are said to have improved the provision of health, education and vocational training, as well as offering cheap food. But it is hard to assess the truth of these claims: strangely, openness and accountability have no place in "21st-century socialism". Mr Chávez may not—yet—be a dictator, as some of his opponents aver, but he is an autocrat. The "defining features" of his Venezuela, according to a report last year by Human Rights Watch, a pressure group, include "discrimination on political grounds" and his government's takeover of the judiciary.

Another is its increased dependence on oil. The fall in poverty owes everything to the surge in the oil price since 1999. Mr Chávez has harried private business; millions more Venezuelans depend on the state for jobs and handouts than a decade ago. The motor of economic growth has been public spending. The state oil company, run now as a political project, produces around a quarter less oil than it did a decade ago, while its debt has almost doubled.

The fall in the oil price, if sustained, thus threatens the country with savage socialist pain. So far Venezuelans have not felt this, because Mr Chávez has raided the reserves of the Central Bank. But the haste with which he has organised the referendum speaks of desperation. There were already signs that Venezuelans were starting to tire of their leader. In December 2007 they rejected his first attempt to abolish term limits (and to modify the constitution in a quasi-totalitarian direction). In local elections last November, Mr Chávez's supporters won a narrow majority but the opposition made important gains.

The danger that consent is replaced by thuggery

This time Mr Chávez has gilded the question by proposing to abolish term limits for mayors and state

governors too. He is also making life harder for the opposition (see article). A quasi-fascist undercurrent within his regime is becoming visible: there was even an attack on a Caracas synagogue last month, though officials eventually condemned it.

Just as the oil price puffed up Mr Chávez over the past few years, now it is diminishing him. His ambition to sponsor a continental movement of radical leftists is being crimped as the money runs short. Even if he wins the referendum, he will face growing discontent at home as the economy moves into recession and inflation rises. His way of governing is plebiscitarian: almost every year in the past decade Venezuelans have been asked to vote in ballots that the president has turned into a referendum on himself, and whose outcome he has then taken as a blank cheque. Without the oil windfall, a majority of Venezuelans are likely to withdraw their consent. If and when that happens, the risk will be that Mr Chávez resorts to bullying to stay in power. Left-of-centre governments elsewhere in Latin America, which have been overenthusiastic in embracing him, must try to ensure that doesn't happen.



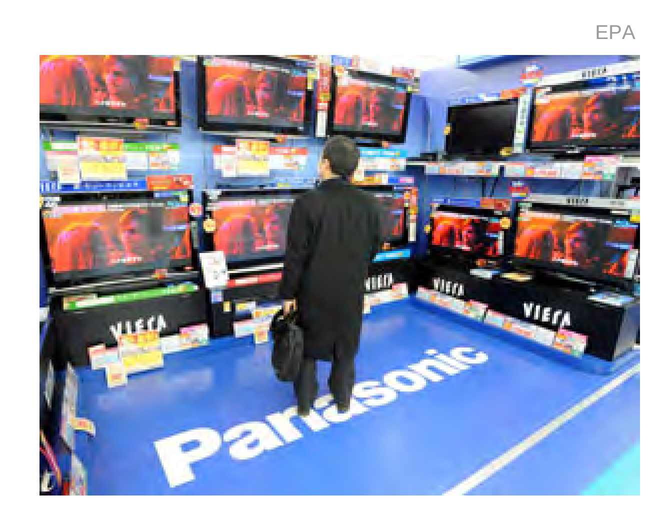

Japanese business

Nothing to lose but their (restaurant) chains

Feb 5th 2009
From The Economist print edition

Many Japanese companies are poorly managed; undoing cross-shareholdings would help change that

EPA



BAD times in Japan may one day come to be seen as good times for corporate Japan. During the country's "lost decade" in the 1990s, Japanese firms shed some staff, but failed to make deeper structural changes. The new crisis has brought a sense of urgency. Companies are beginning to contemplate radical restructuring—if only because the export markets that kept them going during the lost decade have now shut down (see article). Although today's pain threatens to be worse, the hope is that Japan harnesses its misfortune to bring about widespread corporate reform.

The best Japanese companies are very good indeed. After taking market share for decades, Toyota recently surpassed General Motors as the world's biggest carmaker. Nintendo is a stalwart in gaming; Shimano in bicycle parts; Nikon in cameras and the precision lenses for making semiconductors.

Tomatoes and chips

But for every success, there are dozens of failures. At Japanese firms the return on equity is typically half to two-thirds of that at American and European ones. Productivity is poor. Companies tend to focus on the things that can drop on your foot and neglect lucrative revenues from services.

It is a big change from the miraculous corporate history of post-war Japan. In the 1950s "Made in Japan" conjured up images of cheap plastic toys. Just three decades later, its technology firms were obliterating America's consumer-electronics industry and enjoying a reputation for the highest quality.

Today, however, Japanese electronics is emblematic of the problems bedevilling the country's business (see article). Even as they expanded abroad, the new multinationals never really focused their operations. Most ran their own banks, holiday resorts and travel agencies. Sony has more than 1,000 affiliates, including an advertising agency and a restaurant. One Panasonic unit imports canned tomatoes from Italy.

Optimists detect change. Toyota has stopped assembly lines, shuffled its management and considered job cuts. Appearances matter in Japan and the carmaker's zeal is being matched by others. Sony, NEC, Panasonic and Fujitsu have announced overhauls—closing factories, melding business units and shedding staff—that only months ago were unthinkable.

Corporate sprawl distracts managers, diverts resources and muddies valuations. Investors who want to back consumer electronics may not want exposure to hospitals. But many Japanese executives still say that if the units make money (and they often do), then nothing is wrong.

One reform above others would help: to unravel the spider's web of corporate shareholdings that institutionalises the sprawl. Japanese companies and financial institutions together own half of the shares by value on the Tokyo Stock Exchange. In the 1960s this was a way to ward off foreign takeover. Then it was justified as a way to cement business ties.

The main effect of these shareholdings now is to cushion poor managers from market pressure. Public links to other firms limit the number of potential partners. The stakes lock up a company's capital and it is hard to claim they spread risk. When the Tokyo stockmarket ended the year down 42% on a year earlier, the balance sheets of Japan's banks and companies suffered huge losses, pummelling their share prices.

Instead of discouraging corporate shareholding, the government plans to entrench it. On February 3rd the Bank of Japan said it would spend ¥1 trillion ($11 billion) to buy lacklustre shares from banks, to shore up their capital. Meanwhile the trade ministry said it wants to spend ¥1.5 trillion to get banks to buy shares in struggling technology firms (the government would guarantee up to 80% of any losses). A bank rescue is sensible, but not the expansion of their shareholdings. Rather than acting as portfolio managers, Japan's banks and companies would do better to concentrate on running themselves.

Zimbabwe

Wait and see

Feb 5th 2009
From The Economist print edition

Don’t embrace Zimbabwe’s putative new government until there is evidence of real change

Panos



ON JANUARY 30th, after months of repeatedly failed negotiations, Morgan Tsvangirai, the leader of Zimbabwe’s opposition, decided to enter a government of national unity alongside President Robert Mugabe. More accurately, Mr Tsvangirai at last bowed to the huge political and diplomatic pressure exerted on him by South Africa and other regional countries to do a deal. Any sort of government, the neighbours seem to think, must be better than the drift since the election ten months ago when most Zimbabwean voters tried to get rid of Mr Mugabe and his cronies. The neighbours hope foreign governments will rally generously round the Mugabe-Tsvangirai arrangement to help the Zimbabwean people.

Yet saving the credibility of southern Africa’s failed diplomacy on Zimbabwe is not the same as saving the wretched people of Zimbabwe. The new government, if it ever gets going, may well be no better for Zimbabweans than the previous one was. It could be even worse, providing a figleaf of plausibility for Mr Mugabe to carry on his destructive rule.

Mr Tsvangirai had been holding out for good reason. In months of negotiations with Mr Mugabe he had failed to resolve crucial issues such as the release of political detainees and who will have power over the police. He is now gambling that he can win the necessary concessions before the new government is supposed to start work on February 13th.

Sadly that bet may well not come off. Mr Mugabe has a record of unyielding stubbornness when it comes to relinquishing any real power. Years of government thuggery against opposition supporters mean there is no trust left between Mr Tsvangirai’s Movement for Democratic Change and Mr Mugabe’s henchmen. The likely outcome of any unity government is gridlock. The veneer of “power-sharing” will be enough to keep the wily, 84-year-old Mr Mugabe in office. But it is unlikely to give Mr Tsvangirai the authority he needs to end the brutality and rebuild Zimbabwe’s collapsed economy.

Keep the sanctions

America and Britain have already said they will wait and see before offering the new government any direct financial support. Others too should withhold aid to the government and maintain existing sanctions until there is clear evidence that Mr Mugabe is changing his ways. True power-sharing should lead quickly to the release of detainees banged up by Mr Mugabe’s thugs, freedom of the press and an overhaul of the security services. The central bank also needs reform; it presides over an unofficial inflation rate that averaged 15 billion per cent last year. These would be good measures of the unity

government’s intentions.

Contrary to frequent misreporting in Zimbabwe, Western sanctions are targeted very narrowly at Mr Mugabe and those senior ZANU-PF politicians who have helped bring a once-prosperous country to its knees. They have played no part in Zimbabwe’s economic ruin; that is mostly Made in Zimbabwe. Humanitarian aid should continue to flow to those United Nations agencies and NGOs that are directly helping millions of desperately poor and cholera-infected ordinary Zimbabweans. But a real change in their fortunes will come only if the new government in Harare takes the radical steps that Mr Mugabe has spent years resisting.

On the British army, Russian mortality, female executives, Valley Forge, shareholders, Rolls-Royce, delays

Feb 5th 2009
From The Economist print edition

The British army

SIR – What a gloomy picture you paint of Britain's military commitments in Iraq and Afghanistan ("Losing their way?", January 31st). I should like to offer a different perspective. Let me start by saying that our armed forces are exceptional. They adapt to new environments with professionalism, intelligence and commitment, and have demonstrated this time and time again.

Iraq today—dramatically improved from the situation it was in a year ago—owes a huge debt to British forces. Although Operation Charge of the Knights in March last year got off to an inauspicious start, its eventual success and subsequent developments have transformed Basra. Yes, it was led and largely executed by the Iraqis, with coalition forces in support. That was always the intent, and indeed the point. We and our partners put significant investment into the training of these forces precisely so that they would be able, with the right political leadership, to take control of their own destiny. The aim was never for us to run Basra.

Much focus is now on Afghanistan, where again some armchair commentators are unwisely and without the benefit of strategic insight choosing to snipe at the commitment and worth of the British contribution. You say that the Americans are "losing confidence" in our performance. What utter nonsense. It was only recently that Admiral Mike Mullen, chairman of the joint chiefs of staff, said British forces were performing "exceptionally well" on operations. General David McKiernan, the commander of both ISAF (the NATO-led International Security Assistance Force) and American forces in Afghanistan, is also clear about Britain's contribution. He wrote in the *Sunday Times* that: "development in Helmand province has been continuing apace, despite one of the most challenging environments, and I am immensely proud of the work ISAF personnel fulfil in that province. This is particularly true of the British, who have been doing sterling work this winter taking the fight to the enemy and giving them no respite." Those are scarcely the words of an ally who questions our military commitment, as your article suggests.

The joint civil-military task-force in Helmand is having a real impact. It is necessarily slow going; there is a lack of human capital and a weakening of traditional tribal structures after decades of conflict. Progress is halting and erratic, but the overall motion is forward. This is an area where we're going to need patience and persistence. We can and will succeed. We and our American military colleagues, along with our other NATO partners, are of one mind on this.

Sir Jock Stirrup
Chief of the defence staff
Ministry of Defence
London

Russian mortality

SIR – We take issue with your article about our study, where we show an increase in mortality associated with rapid mass privatisation in the post-Soviet period ("Mass murder and the market", January 24th). Your comments may be explained by your use of a misleading graph of Russian life expectancy and your lack of awareness of the extensive existing literature on the other factors you cited, especially alcohol. Our question was why populations that went through similar political changes to Russia had extremely different mortality experiences. However important their similar historical legacies may have been, they cannot account for the differences in magnitude of the fluctuations in death rates that occurred in the former Soviet states during the early 1990s.

Our study indicates that one explanatory factor was whether a country undertook mass privatisation. We know that alcohol was important, but the crucial question is why did people feel the need to drink

dangerously? Although post-Soviet Russia and Belarus had similar rises in vodka consumption after the Soviet alcohol monopoly broke up, only in Russia did unemployment and death rates surge among working-age men. In these two otherwise similar countries, the pace of privatisation was one of the few things that differed.

No simple explanation of health exists for any population, and certainly not for those undergoing rapid transition. Many factors contributed to the post-communist mortality crisis, but by using evidence rather than ideology, we are confident that rapid privatisation was one of them.

David Stuckler
Department of sociology
Oxford University
Oxford

Lawrence King
Department of sociology
Cambridge University
Cambridge, Cambridgeshire

Martin McKee
London School of Hygiene and Tropical Medicine
London

Management style

SIR – Your profile of Carol Bartz, the new boss of Yahoo!, shows that the double standard applied to male and female executives continues to thrive (Face value, January 17th). Ms Bartz's weekly red-eye flights home from Silicon Valley for three-day weekends with her family proved that she regards the notion of "work-life balance" as "nonsense". When she was chief executive of Autodesk, "reading and working" in a chauffeur-driven car displayed "excessive" discipline. She became "homecoming queen and a mathematics star in high school", which no doubt helped her to overcome "insecurities that would forever motivate her to achieve" after the death of her mother. Born just a few years before Steve Jobs, she is nonetheless "strikingly old" to take charge of an internet company.

I look forward to reading soon about some newly appointed male chief executive, whose popularity and achievement in high school, whose regular business travel and efforts to provide a comfortable suburban home for his family, and whose passage into the winter of life at 60 give us insight into his potential success at his new job.

Patti Hunter
Santa Barbara

Words that try men's souls

SIR – I'm sure that the passage quoted by Barack Obama in his inauguration speech that mentioned America's bleakest winter, "when nothing but hope and virtue could survive", was not a reference to the young republic's dire circumstances at Valley Forge in 1777-78 ("Yes you must", January 24th). The passage came from Thomas Paine's "The American Crisis", which was read to George Washington's troops shortly before the famous crossing of the Delaware river in December 1776. Washington had retreated from New Jersey in the autumn, but after crossing the Delaware the Americans won the Battle of Trenton, a victory over Britain's Hessian allies.

Bryan Carter
Minneapolis

No reasons to be cheerful

SIR – You say you are "puzzled" that, after continued government support, bank shareholders are not "rejoicing" ("Another fine mess", January 24th). Could that be because they have lost nearly all their

money? Severe dilution of existing ordinary shares in several large British banks precludes any realistic prospect of recovery in their value. If that evokes joy at *The Economist* then I have a number of holdings you might be interested in acquiring—at an appropriate price.

Bill Watts
Shepperton, Surrey

The following letters appear online only

Made in Britain

SIR – In one sense Rolls-Royce is a company that does not define the pattern of British manufacturing ("Coming in from the cold", January 10th). The aero-engine-maker had exceptional help from government in pursuing very long-term strategies of technical development. Even after privatisation the British government retained a "golden share" that protected Rolls-Royce from takeover. As you and others reported from time to time in the 1980s and early 1990s, this led to frustration among its institutional shareholders, unable to bully it into the myopic strategies that dug the graves of many British manufacturers.

Now Rolls-Royce is indeed "Britain's lonely high-flier". The recent growth in manufacturing production has been mostly in foreign-owned firms. It has been deeply unfashionable to blame the City for this or anything else. It may now at last become possible to discuss how the City may be reformed so that new Rolls-Royces might be nurtured in the future.

Andrew Tylecote
Professor of technology management
University of Sheffield
Sheffield

Life on the Northern Line

SIR – Your linking of London Underground's Northern Line with "delays" may have been apt a year ago, but it is now out of date ("Free-ish", January 17th). Today the Northern Line outperforms all other 11 Underground lines. Improving reliability on the Northern Line, which is the oldest and most complex line on the network, has been slow, but our massive capital injections over the past six years and improvements to management and maintenance are now paying dividends with a 65% improvement in reliability since 2003.

No one ever envisaged this turnaround in performance prior to the completion of upgrades to the line, which will be completed in 2011 and increase capacity on the line by up to 30%. In the meantime, we will continue with our investment to further improve the Northern Line's performance for passengers and who knows, one day people will find a new negative comparator.

Lee Jones
Director of operations
Tube Lines
London

Divorce

Money in misery

Feb 5th 2009
From The Economist print edition

International marriages are crumbling with the global economy, revealing unseen pitfalls in cross-border divorce law. Good news for lawyers

Tim Marrs



MARRIAGES that thrive on money may wither with thrift. That is a depressing lesson from the world economic crisis, which has brought a surge in business for divorce lawyers in former boomtowns such as London and New York. When one or both spouses is from a foreign country, divorce is not just sad but complicated too—especially when most assets may be in a third country, a pension in a fourth, and offspring in a fifth.

Globalisation has made binational marriages, once exotic, much more common among high-earning, highly mobile families. When they stop being high-earning, life gets tricky. Louise Spitz of Manches, a London law firm, has observed an "exceptional" period since September. "With the redundancies in the City there has been a concomitant wave of marital upheaval," she says. "Families used to living on huge bonus income are unable to continue with the commitments they have taken on—housing and school fees and the cost of living the high life." Manches has taken on eight more divorce lawyers to cope with the extra work. A high proportion, Ms Spitz and other lawyers reckon, of the once-rich couples now breaking up include at least one foreign spouse.

So who sues whom for divorce and where? How much money will be awarded to whom? Will it be collected? And how? The answers are far trickier than most non-lawyers would imagine. Take, for example, this lightly disguised but real-life example: a wealthy philandering Texan banker with a French wife. Formerly resident in New York, with a recently-lost good job and rented house in London, he now plans to move back to Texas. His wife, newly suspicious and with no money of her own, wants to take the children home to France. She needs her family, she says. What she actually needs is urgent, specialist legal advice.

A London divorce settlement might give her many millions: a house, school fees and maintenance until the children are adults, or even indefinitely. An English court may well disregard a prenuptial agreement, particularly if one of the parties did not have independent legal advice. And it will tend to care more about immediate needs than about whether assets were acquired during the course of the marriage, or predate it, or are the result of an inheritance. All assets are likely to be divided. If the wife is lucky, she may even be able to collect her share.

In the wife's native France, things will look very different. In her favour is that conduct counts—so adulterous spouses will be penalised. In most other Western countries, divorce courts have given up attributing blame. Even domestic violence is often ignored, though it still counts heavily in some jurisdictions, such as Florida.

But in the typical French divorce, any alimony (also called maintenance) will be less and for eight years at most; any prenuptial agreement will be binding. Only assets acquired during the marriage are up for grabs. If, in our example, the American husband moves to France, he will be expected to play an equal part in bringing up the children—a requirement that would delight some fathers, but by no means all.

Where to split

International comparisons of divorce law

Jurisdiction	England & Wales	New York	Germany	France
Pre-nuptial agreement	Rare, non-binding but can influence judge	Increasingly common among older and richer couples, normally binding[*]	Uncommon, normally binding	Common, binding
Accrued assets	Judge's discretion, based on "fairness, equality and needs"	"Equitably" divided; usually 50-50 but judge has discretion	50-50	Usually 50-50
Pre-marriage assets	May be included	Excluded[†]	Excluded[†]	Usually excluded
Maintenance[‡]	Quite common, often lifelong	When needed to maintain marital standard of living	Limited	Normally limited to eight years
Share of future earnings	For super-rich, sometimes	Based on contribution to marriage	Included in maintenance	No
Time and money	Variable	Quickish and costly	Quicker and potentially cheaper	Slow and cheap
Adultery and other misconduct	Usually no effect on financial outcome	Ignored[§]	Ignored[§]	Relevant

Source: *The Economist*

[*]Except where fraud, duress or non-disclosure can be proved [†]Unless mingled or actively managed during marriage [‡]Called alimony in some jurisdictions [§]Barring financial recklessness

If the errant husband has the divorce filed in Texas, the tables are turned even more dramatically. The wife risks being left penniless. In Texas state law, alimony is usually minimal and temporary—though child support, thankfully, is a federal matter. In America, the law varies hugely between states. Most exclude from the settlement assets acquired before the marriage (but Michigan and Colorado don't). Most exclude inherited property (but Massachusetts and Oregon don't). In most states, judges will enforce prenuptial agreements (but they often won't in Alaska).

If the Texan husband decides to file in New York, however, he may find the outcome startlingly expensive. As in some English court rulings, New York courts may award one party a share of a spouse's future earnings—assuming that they are based on a qualification, such as an MBA or medical degree, that was earned thanks to a joint effort in happier times. Yet New York law has one big catch: unless the parties have signed a formal separation agreement it requires proof of cruelty, adultery or abandonment, whereas other states allow "irreconcilable differences" as grounds for a divorce. So binational couples in New York who want to end their marriage may find themselves unable to do it there, and squabbling about alternatives. Rules differ, too, on what constitutes residency in a particular jurisdiction. In hedonistic Las Vegas, six weeks is enough.

According to Jeremy Morley, an international divorce lawyer based in New York, hiding assets from a spouse is also much easier in some countries than in others. California, at one extreme, requires complete disclosure of assets. At the other extreme, Austria, Japan and many other countries require very little disclosure. A California court recently ordered a husband to pay $390,000 in costs and penalties to his wife because he did not disclose some significant financial information. In another jurisdiction, the assets could have stayed hidden.

Who gets the children?

Cash and kids may pull in different directions. Countries that are "man-friendly" (shorthand for favouring the richer, usually male, partner) when it comes to money may be "mum-friendly" when it comes to custody. Japan, for example, is quick and cheap for a rich man—unless he wants to keep seeing his children. English courts are ferocious in dividing up assets, even when they have been cunningly squirrelled away offshore. But compared with other jurisdictions, they are keen to keep both divorced parents in touch with the children.

The children's fate, even more than family finances, can be the source of the hottest legal tussles. The American State Department unit dealing with child abduction has seen its caseload swell from an average

in recent years of 1,100 open cases to 1,500 now. In Britain, the figures rose from 157 in 2006 to 183 in 2007, according to Nigel Lowe of Cardiff Law School.

Of the cases reported worldwide, mothers are the main abductors when a marriage breaks down. They are cited in 68% of cases. Ann Thomas, a partner with the International Family Law Group, a London law firm, says child abduction has increased “dramatically” in the past three years or so. A big reason is freedom of movement within the European Union, which has enabled millions of people from the new member states to live and work legally in the richer part of the continent. That inevitably leads to a boom in binational relationships, and in turn more children of mixed marriages. Ms Thomas notes that when a relationship between a foreign mother and an English father breaks down, the mother often assumes that she can automatically return to her homeland without the father’s permission. That may be a costly legal mistake.

Tim Marrs



Most advanced industrialised countries, plus most of Latin America and a sprinkling of others, are signatories to the 1980 Hague Convention, a treaty which requires countries to send abducted children back to the jurisdiction where they have been living previously. That is fine in theory: it means that legal battles have to be fought first, before a child is moved. It is a great deal better than a fait accompli which leaves one parent in possession, while the other is trying to fight a lengthy and expensive legal battle in a faraway country.

But in practice things are very different. Views on the desirability of children being brought up by “foreigners” vary hugely by country; so do traditions about the relative roles of fathers and mothers in bringing up their children after divorce. In most Muslim countries, for example, the assumption is that children over seven will be brought up by the father, not the mother, though that is trumped by a preference for a local Muslim parent. So the chances of a foreign mother recovering abducted children from a Muslim father are slim. Apart from secular Turkey and Bosnia, no Muslim countries have signed the Hague Convention, though a handful have struck bilateral deals, such as Pakistan with Britain, and Egypt and Lebanon with America.

Japan has not signed it either—the only member of the rich-country G7 not to have done so. Canada and America are leading an international effort to change that. Foreign fathers, in particular, find the Japanese court system highly resistant to attempts even to establish regular contact with abducted and unlawfully retained children, let alone to dealing with requests for their return. Such requests are met with incomprehension by Japanese courts, complains an American official dealing with the issue. “They ask, ‘Why would a father care that much?’” Countries edging towards signing the Hague Convention include India, Russia and mainland China. But parents whose ex-spouses have taken children to Japan should not hold their breath: as Ms Thomas notes, even if Japan eventually adopts the Hague Convention, it will not apply it retrospectively.

Games with different rules

Moreover, even signatory countries may be bad at abiding by the convention, especially when it means enforcing the return of children to a parent alleged to have been abusive. The annual State Department

report to Congress on observance of the Hague Convention lists Honduras as “non-compliant” and nine other countries (Brazil, Bulgaria, Chile, Ecuador, Germany, Greece, Mexico, Poland and Venezuela) as showing “patterns of non-compliance”. Anyone in a wobbly marriage with a citizen of these countries might bear that in mind before agreeing to let the children go on holiday there.

But America is not blameless either, particularly if parents try to recover their children through state rather than federal courts, where judges may be unaware of the Hague Convention’s requirements. “Except in Florida, New York, California and Texas, a judge may only hear one Hague case in his career,” says a State Department official. Judges who get it wrong can be overruled on appeal, but it takes time and money: the Hague Convention aims to make proceedings quick and cheap, thus making abduction less likely. Whereas Britain offers automatic legal aid to the foreign parent trying to recover the children, in America they must rely on their own resources or a pro bono lawyer.

Making wily choices about possible jurisdictions is often criticised as “forum shopping”. But the stakes are high: ending up in the wrong legal system, or with the wrong approach, may mean not just poverty but misery. Mr Morley says the differences between one divorce jurisdiction and another are far more than, say, playing a sporting fixture at home or away. As the table shows, totally different rules apply.

So it is understandable that a disillusioned spouse, and his or her lawyer, will try hard to get the most favourable jurisdiction. Yet that can all too easily lead to each party starting, or even finishing, a divorce in a different country. Sorting out these cross-border legal wrangles can be colossally expensive. A tussle between jurisdictions usually starts in six figures, in dollars, euros or pounds; when all four legal bills, of both sides’ costs in both countries, are totted up, it easily shoots into seven figures. And it is hugely time-consuming. The children involved may reach adulthood before the final verdicts are given.

International attempts to tidy up the law have made some things better, but not all. The European Union (where 875,000 divorces take place each year, a fifth of them binational) introduced a reform in 2001 called Brussels II. This has largely stopped “forum shopping”, with a rule that the first court to be approached decides the divorce.

The problem with this rule is that it encourages those in troubled marriages to end them, not mend them. Even if a marriage is doomed, the trend in family law is to resolve the dispute out of court, typically through mediation. A race to issue proceedings makes it much more likely that matters will get nasty, as well as lengthy and costly. David Hodson, an international family law specialist, notes sadly that “This law works against reconciliations and resolutions out of court. Cases can be won and lost by one spouse issuing a divorce a matter of minutes before the other spouse. That must be wrong.”

Tim Marrs



The law of dirty tricks

Brussels II also encourages some less scrupulous lawyers to behave badly, urging their clients to act fast and dirtily. A London divorce lawyer recalls a case where a husband from an overseas country had acquired his wife’s European nationality by marriage, living briefly in her continental home country before moving to London. Five years and two children later, the marriage was on the rocks, with the husband away working in East Asia. Without his wife’s knowledge, he filed for divorce in her country, one of the stingiest jurisdictions in Europe (from her point of view). His only connection with it was his marriage to

the wife he was trying to dump cheaply. Had the case been heard in London, where both parties had much stronger links and had owned a home for years, she would have done far better.

To avoid such cases, a further EU measure, Rome III, tried to stipulate that a marriage should be ended only by the law that has governed it originally. That works fine in similar countries where divorce rules are highly codified, precedents do not matter and judges' discretion is limited. It already applies in some northern European countries, so that Dutch courts, for example, will apply French law when dealing with a French couple whose marriage has ended during a posting in The Hague.

But such a rule works much less well when other systems are involved. English law is much more complex, and is based on intricate precedents and judges' discretion that cannot simply be looked up and applied. Even greater difficulties arise when couples come from more distant countries. Would a Swedish court want to apply *sharia* law to a divorcing couple recently arrived from Saudi Arabia? Many Swedes flinched at that. Mr Hodson complains that it would mean that "the essence of a country's community life found in its family laws is removed and replaced by the laws of another country." In the United Kingdom, he says, it would be "entirely against [national] law and policy."

For richer, for poorer

Now that Rome III has been stymied, a group of nine countries, led by Spain and France, is going ahead under a provision in EU law known as "enhanced co-operation". This allows like-minded countries to work together, leaving the unwilling behind. And still more international tidying-up operations are in the works. Another Hague Convention tries to harmonise arrangements on cross-border child-support payments—an area that tends to be a bit less contentious than divorce, where views of what is fair differ wildly.

Perhaps the biggest weakness of the system is the advantage that it gives to the richer partner when an international marriage breaks up. Experienced lawyers can operate, if necessary, with high speed to help the poorer spouse—for example, by putting the first hefty legal bill on the husband's credit card before he is aware of what his wife is up to. In England, that may be followed by a swift move to initiate divorce proceedings, and then an emergency maintenance application that includes provision for legal costs. When the richer party has assets in that jurisdiction, a fair fight is possible. But Kerstin Beyer, a German-British divorce lawyer at the International Family Law Chambers in London, says the tables are often stacked against the poorer (and usually less knowledgable) spouse. Some husbands file for divorce abroad and simply fail to turn up at the English court, hoping that the cost and delay of enforcing the judgment abroad will lead their ex-wife to give up. A client of hers trying to gain the assets she had been awarded in Colorado was faced with a demand for a $15,000 upfront payment from a lawyer there: an impossible expense for someone of her means. Another has been pursuing, expensively and so far fruitlessly, assets in Luxembourg and Germany awarded by a London court. Pensions are particularly tricky. Some countries split them between divorcing couples as a matter of course; others regard such requests from foreign courts coldly.

More fundamentally, divorce arrangements in countries with English-style common law are still liable to be influenced by highly atypical fights between the super-rich, who can afford to take cases to the highest courts. In most marriages there is barely enough money to support one family in one country, notes Ms Spitz. Spreading that between two sides is a stretch, even without an expensive legal fight. As house prices plunge and savings shrivel, divorcing couples are fighting over a shrinking cake.

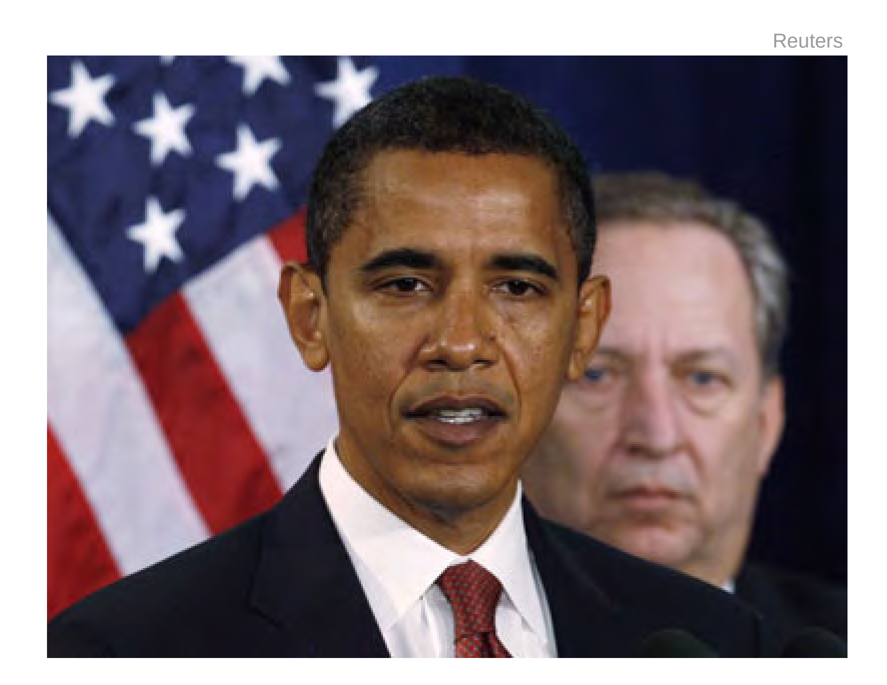


Economic policy

Can the centrists hold?

Feb 5th 2009 | WASHINGTON, DC
From The Economist print edition

Reuters



As politics reverts to its usual fractious state, Barack Obama's centrist advisers, the unions and the angry left in Congress are all competing for his ear

IT HAS been a rough few days for Barack Obama. He has lost, in Tom Daschle (see article and Lexington) a close ally on whom he depended for his health-reform plans. Mr Daschle is now the third of his planned appointees to fall by the wayside; Mr Obama's carefully cultivated image of competence and coolness is starting to fray. Worse, as *The Economist* went to press the new president's vast stimulus plan (now worth around $900 billion) faced the prospect of substantial change if it is to pass the Senate where Republicans hold a blocking minority; it was rammed through the House without attracting a single Republican vote in favour.

But the re-emergence of the usual partisan sound and fury obscures a much more interesting question. Mr Obama amassed a solidly liberal record as a senator, then moved towards the centre during the campaign and surrounded himself with centrist advisers. Is his party now dragging him back to the left?

It is early days, but those who see a leftward tilt have a case. On January 29th Mr Obama gave a clue to his priorities by making the first bill he signed into law the Lilly Ledbetter Fair Pay Restoration Act, which gives workers substantially more time to file suits claiming pay discrimination on the basis of sex, race or religion. The US Chamber of Commerce claimed it would "dramatically expand the number of frivolous and otherwise questionable" lawsuits against employers. The next day the president, in front of invited union representatives, signed executive orders making it harder for federal contractors to discourage union activities and requiring them to offer jobs to the previous contractor's employees. "I do not view the labour movement as part of the problem; to me it's part of the solution," he declared.

Along with these pro-labour gestures came a series of broadsides against Wall Street. On January 29th Mr Obama attacked as "shameful" and the "height of irresponsibility" the $18.4 billion in bonuses that Wall Street bankers collected last year when their firms were receiving federal aid. On February 4th he announced that executives of companies receiving "exceptional" aid (there are currently only three such) would be restricted to $500,000 a year in pay. Earlier, Larry Summers (pictured above with the president), Mr Obama's usually reliably centrist chief economic adviser, had told Congress that banks receiving additional bail-out money would face restrictions on mergers and dividends. Healthy banks would have to "increase lending above baseline levels", a stricture that could lead to more bad loans.

Free-traders shuddered when, on January 22nd, Tim Geithner—then the nominee for treasury secretary but now confirmed in the job—accused China of manipulating its currency to gain a trade advantage. Whether it really does is debatable (see article), and his accusation antagonised China while stoking the fires of protectionism.

Still, there is less to all this than meets the eye. The Lilly Ledbetter Act more or less restores (though partly strengthens) the rights of aggrieved workers that a Supreme Court ruling circumscribed in 2007. Similarly, the Obama orders affecting federal contractors simply reversed Bush decisions, restoring the 1990s status quo.

Mr Geithner's blast at China was a restatement of Mr Obama's campaign position, and was buried in 102 pages of written answers to senators vetting his confirmation. It appears that his answer was prepared hastily, and administration officials have since played it down. And Mr Summers's promise to judge banks against lending baselines was porous enough to allow considerable discretion in assessing whether a bank is lending enough.

The stimulus bill is itself a mishmash of Mr Obama's progressive priorities and short-term expedience. In keeping with long-standing promises, it offers some $140 billion in "Making Work Pay" tax credits, worth up to $1,000 to families earning less than $150,000. Like his restrictions on executive pay, this will tilt the distribution of income away from the very rich. On the other hand, its health-care assistance to the poor and unemployed are piecemeal and temporary, designed for quick impact, not as a down-payment on Mr Obama's more sweeping ambitions (see article).

Go forth and multiply

Estimated impact on GDP of the fiscal stimulus package

Type of stimulus	Examples	Multiplier*
Direct federal spending, federal funding of state and local infrastructure	$165 billion on infrastructure improvements and science	1.0 to 2.5
Non-infrastructure transfers to states	$87 billion for Medicaid; $79 billion for fiscal stabilisation	0.7 to 1.9
Payments to individuals	$47 billion in unemployment insurance; $26 billion in health-insurance subsidies	0.8 to 2.2
Temporary individual tax cuts	$142 billion Making Work Pay credits	0.5 to 1.7
Tax loss carry-back	$15 billion	0.0 to 0.4

Sources: Congressional Budget Office; congressional committees

*Dollar increase in GDP per dollar of stimulus

Mr Obama made great show of his commitment to public infrastructure but the package spends almost as much on cash grants to states and the unemployed largely because this money can be spent quickly with a relatively large impact on gross domestic product (see table). It also includes a sprinkling of business tax cuts, in part to tempt Republicans to vote for it.

But the real litmus tests for Mr Obama are still to come. Labour's priority is the "Employee Free Choice Act", which would allow unions to organise without a secret ballot. Business is fiercely opposed. Mr Obama supported it as a candidate. But last month he told the *Washington Post*, "If we're losing half a million jobs a month, then there are no jobs to unionise, so my focus first is on those key economic priority items."

Whether Mr Obama has buried his past scepticism about trade will be revealed by whether he forces Congress to remove "Buy American" provisions from the fiscal stimulus bill; he has already persuaded the Senate (though not the House) to water them down. Federal procurement policies already include some provisions of this sort; the law would extend them to iron, steel, uniforms and potentially any manufactured products in projects paid for with stimulus money.

Gary Hufbauer and Jeffrey Schott of the Peterson Institute, a think tank, think they would create just 9,000 jobs while potentially costing far more through retaliation. Mr Obama said he opposes provisions that violate World Trade Organisation rules or "signal protectionism". But if the provisions stay, will he veto the bill?

Another test will be whether the Treasury formally brands China a currency manipulator in a few months' time. On fiscal policy, the president has yet to explain how the budget deficit, which this year will be the largest as a share of GDP since 1945, will be reined in, or how he will contain health and pension

spending on the old. He has promised a "fiscal responsibility summit" to tackle those questions.

Mr Obama continues to seek sensible economic advice. It was emblematic of George Bush's low regard for economists that in 2003 he moved the Council of Economic Advisers (CEA), the administration's in-house think-tank, from the White House complex to a drab office building a block away. Mr Obama has moved it back. Each morning he gets a memo prepared the previous night by the CEA and the Treasury, then spends about 30 minutes with his economic team. In regular attendance are Mr Summers, Mr Geithner, Peter Orszag (the budget director) and Christina Romer, who chairs the CEA.

Mr Obama also continues to fill his administration with highly-regarded technocrats. They are said to include Gene Sperling, a former economic adviser to Bill Clinton; David Cutler, a Harvard health-care economist; Peter Henry, a Stanford University economist and advocate of free international capital movements; Jeremy Stein, a Harvard economist specialising in corporate finance; and Diana Farrell, who headed the think-tank affiliate of McKinsey. Joining Ms Romer on the council are Cecilia Rouse, a labour expert from Princeton, and Austan Goolsbee, a long-serving Obama adviser now grappling with the foreclosure crisis.

Mr Obama once called himself a "blank screen on which people of vastly different political stripes project their own views." In the coming months, the world will have a chance to decide which image of Mr Obama is the right one.



The new president's plans

Stealth care

Feb 5th 2009 | NEW YORK
From The Economist print edition

Barack Obama's health agenda has been harmed by Tom Daschle's fall

WAS Tom Daschle so uniquely gifted that his departure from the twin posts of health secretary and White House health tsar must now set back Mr Obama's health-reform efforts? In the short term, the answer is yes. Mr Daschle's unusual strengths as both an elder statesman of the Senate and a serious policy wonk meant that he, more than anyone, might have been able to get the job done.

His fall is a pity, because the Republicans are already unsheathing their knives. The president has included a handful of health measures in his big stimulus package, such as the temporary expansion of health insurance for the unemployed; but these mostly sensible steps are already being denounced as socialist medicine by stealth. When Mr Obama signed a law expanding SCHIP, a health scheme that covers children in poor families, on February 4th, his opponents loudly decried it.

But the downturn means it is probably a good idea to expand schemes such as Medicaid, the government's health plan for the indigent, and to give more money to cash-strapped state governments struggling to meet health obligations. A recent study by the Kaiser Family Foundation, a think-tank, suggests that every 1% increase in unemployment leads to an increase of 1m in the number of unemployed and 1.1m in the numbers joining Medicaid and SCHIP.

Any long-term reform package will be a much harder sell. When will such a scheme be unveiled? As recently as on February 2nd Jeanne Lambrew, the deputy director of the newly created White House Office of Health Reform (and Mr Daschle's supposed lieutenant), told a conference in Washington, DC, that the new Obama health plan would move forward in a "few short weeks".

Mr Daschle's departure makes that timetable much less feasible. The fiercest struggle over health legislation is likely to come in Mr Daschle's old stomping ground, the Senate; the Republicans have the votes to block proposals there. Late last year the smart money said that Mr Obama would get enthusiastic support for early action on this topic, because Senator Ted Kennedy wants to tackle health care before cancer demands his retirement.

Alas, a fellow Democrat threw a monkey wrench in the works. Senator Max Baucus, the powerful head of the Finance Committee, put forward a rival health plan and has been making much noise about its virtues. Mr Kennedy's camp is said to resent this effort, which may hurt the liberal lion's efforts to seal his legacy. It is precisely such a tangle that Mr Daschle, a former majority leader of the Senate, could have untied. Now the wrangling seems likely to go on for some time.

Look beyond the immediate mess, though, and it becomes clear that Mr Daschle's downfall need not mean the demise of Mr Obama's health-care efforts. Indeed, there is still a strong case for acting sooner rather than later. Harry Truman and Bill Clinton both came to the presidency with ambitious plans for health reform, but dragged out consultations for so many months that public opinion turned against them both. It seems that voters support the general idea of fixing health care; but the more they hear of the trade-offs involved, the less enamoured they are. With or without the help of Mr Daschle, Mr Obama would be sensible to strike while the iron is still hot.

Infrastructure

Be careful what you wish for

Feb 5th 2009 | CHICAGO AND NEW YORK
From The Economist print edition

Spending on infrastructure could easily run amok

“WE WILL create millions of jobs by making the single largest new investment in our national infrastructure since the creation of the federal highway system in the 1950s,” declared Barack Obama back on December 6th. The words rang blissfully in the ears of enthusiasts for public works across the country.

AP



Not all the money will be wasted

Then came the stimulus proposals in Congress. On January 28th the House passed an $819 billion bill with about $100 billion devoted to infrastructure, according to the American Society of Civil Engineers (ASCE). The Senate’s version, at around $900 billion, is still under debate. Whatever emerges from Congress, it will be merely a “down-payment”, says Ed Rendell, Pennsylvania’s gravel-voiced governor.

A main conflict lies between the need to spend quickly and the desire to spend well. Much emphasis has been placed on projects that are “shovel-ready”, and with good reason. Every $1 billion spent on transport infrastructure creates 35,000 jobs, according to the Department of Transportation. The rush to spend, however, may exacerbate a troubling trend. For years federal money has been distributed haphazardly. Now, as David Paterson, New York’s governor, dryly puts it, “Everyone with a shovel says they’re shovel-ready.” A few bad projects are seeking new life from the stimulus. Connecticut is rumoured to be reviving an old plan to build a road long dismissed as unnecessary.

There is at least one way to reconcile speed with strategic investment. Robert Puentes of the Brookings Institution, a think-tank, suggests that money should be spent only on maintaining existing assets such as pipes, roads, public transport and bridges. Money would not be thrown at unworthy new projects. Fixing old roads also supposedly creates 9% more jobs than building new ones. Such a provision, however, is not in place. The states have almost complete jurisdiction over how the stimulus money is spent; Congress is not even earmarking funds for particular purposes.

Some states are planning well. Others are more problematic. Almost half of Massachusetts’s transport request is devoted to buses and trains, which create 19% more jobs than investing in new roads. All the money for roads will go towards maintenance. The transport requests of 19 states are public; of these, more than half have asked for 80% of the funding to go to roads, mostly towards new ones.

One advantage of the stimulus, according to Mr Puentes, is that it will track where money is spent, so that politicians will see which investments are still needed. This presumes that the stimulus is only the beginning of a larger, more strategic plan. Robert Yaro, of New York’s Regional Plan Association, is concerned that there is still no national vision. On January 28th ASCE estimated that $2.2 trillion is needed over the next five years to raise the nation’s infrastructure from a “D” to a “B”. The House bill has only $9 billion for public transport and $30 billion for highways. An amendment to add $25 billion in infrastructure spending to the Senate’s bill failed on February 3rd. This may be a blessing, given how the money is likely to be spent.

The Republicans

Reassembling the wreckage

Feb 5th 2009 | WASHINGTON, DC
From The Economist print edition

The Republicans' new chairman must rebuild their ship in a hurricane

MICHAEL STEELE, a former lieutenant-governor of Maryland who was elected chairman of the Republican National Committee (RNC) on January 30th, has several things in common with Barack Obama. He dresses sharply, smiles handsomely and intones snappy platitudes with telegenic conviction. "Too many of our children are headed for the state pen instead of Penn State [a university]," he says.

Mr Steele is also black, a fact that matters more than it should. To start winning elections again, the Republicans must attack Mr Obama's record, when he has one. Democratic sympathisers will try to portray such attacks as racist. Getting an African-American to deliver them makes that charge less plausible.

Beyond that, however, the parallels cease. Mr Steele has neither Mr Obama's intellectual fizz nor his ability to fire up supporters. His unscripted thoughts can be sloppy. And many in his party are suspicious of his moderation. He slammed George Bush's handling of Iraq and Hurricane Katrina. Although a pro-life Catholic, he co-founded a group that backs Republicans who are pro-choice and pro-gay. He opposes the death penalty. And he does not own a gun. But the RNC's 168 members reckoned that Mr Steele was conservative enough, especially on taxes. His job is not to write policy, but to sell it. Since he comes across as affable and reasonable, both to party activists and swing voters, he will probably do this well.

What is less clear is whether he has the political and management skills to rebuild a party organisation that looks decrepit next to Mr Obama's high-tech electoral machine. The Republican brand is slipping ever deeper down the drain. A recent Pew poll found that even white evangelical Protestants—traditionally the staunchest Republicans—narrowly prefer Democrats these days.

Meanwhile, Mr Obama continues (though less effectively than he hoped) to reach across the aisle. This week he asked Judd Gregg, a Republican senator from New Hampshire, to be his commerce secretary. As part of the deal, the Democratic governor of New Hampshire appointed a Republican replacement, Bonnie Newman. She will serve until an election is held in 2010. In the 1990s, as a footsoldier in Newt Gingrich's anti-government revolution, Mr Gregg voted to axe the Commerce Department. Now he plans to head it. Times change.

Minnesota's Senate seat

Three months and counting

Feb 5th 2009
From The Economist print edition

The interminable struggle between Al Franken and Norm Coleman

WASHINGTON, DC, is focused on 2009 and John McCain's candidacy seems a distant memory. Minnesota, however, is stuck in 2008. Al Franken, a Democratic challenger, and Norm Coleman, the incumbent Republican, continue to battle for a Senate seat. On February 3rd, three months after the election, a court ruled that 4,800 ballots might be recounted.

The spectre of Florida hangs over any close race. The "hanging chad" contest between Al Gore and George Bush in 2000 exposed the dysfunctional side of American democracy. Some argue that Minnesota's recount has been riddled with human error. Many others prefer to view the fight as a model of open procedure. Everyone can agree, however, on at least one point: Minnesota's process is very slow.

Minnesota requires a recount when the margin of victory is less than 0.5%. As the recount began (not till November 19th) Mr Coleman led by only 215 votes out of 2.9m cast. A media frenzy was inevitable. There was a chance that Democrats might win a filibuster-proof majority in the Senate; and Mr Franken used to be a comedian.

Nevertheless David Schultz, a political scientist at Minnesota's Hamline University, contends that what followed was an "exceedingly orderly process". First came the counting of votes. Several factors helped this proceed relatively smoothly. Minnesota uses optical-scan machines, which read paper ballots marked by voters, so hanging chads were nowhere to be seen. Perhaps more important, Minnesota has thorough guidelines for election officials. For example, if a voter ticks an oval on the ballot, rather than filling it in, an official may count that vote for the checked candidate. Florida had few such rules.

The second stage eventually began on December 16th, when a bipartisan "canvassing board" began to examine ballots that either campaign had challenged for being unclear, invalid or improperly judged. On January 5th it ruled that Mr Franken had won the contest by 225 votes. Yet this was by no means decisive. Ben Ginsberg, a lawyer for Mr Coleman, called it merely "half-time".

On January 6th, as other senators returned to Washington, Mr Coleman filed an "election contest", to be tried before a three-judge panel. Mr Coleman has reason to quibble. One hundred and thirty-three ballots disappeared after election night. Some votes, he also claims, may have been counted twice. But the main thrust of his case concerns absentee ballots. Election officials rejected 12,000 of them; Mr Coleman argues that the ballots were judged by different standards, violating the federal "equal protection" clause cited in *Bush v Gore*. More troubling to observers, however, was a state Supreme Court decision that let the campaigns veto absentee ballots in the recount. "They were disenfranchising voters" contends Mark Halvorson, director of Citizens for Election Integrity. On February 3rd the panel dismissed any comparison to Florida, but said 4,800 ballots might be reconsidered.

The trial will stretch out for weeks, and doubtless be followed by an appeal. Mr Franken is challenging a state law that forbids the election to be certified until all legal contests are settled. He is unlikely, however, to cut the process short. All in all, argues Larry Jacobs, a professor at the University of Minnesota, the recount is "a very positive model for other states to consider." Minnesotans can only hope that their model someday produces a senator.

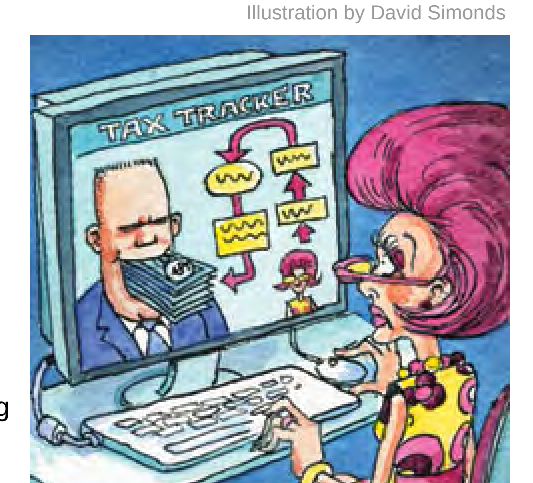
Open government

Track my tax dollars

Feb 5th 2009 | AUSTIN
From The Economist print edition

A worthy idea whose time has come

Illustration by David Simonds



THE taxpayers do their part, and faithfully fling their hard-earned treasure into the gaping public maw. Surely they should be allowed to know what happens to it. So why not put government spending online?

It is a good idea that began in Congress, of all places. In 2006 Barack Obama and Tom Coburn, then freshman senators from Illinois and Oklahoma, sponsored a bill calling for an online database of federal contracts and awards. Robert Byrd of West Virginia and Ted Stevens of Alaska, both notorious for pork, briefly blocked the idea with an old Senate trick, the anonymous hold. They were soon unmasked by the blogosphere. The Federal Funding Accountability and Transparency Act sailed through to passage with bipartisan support.

Since then, more than 20 states have put up some kind of spending database. Some of their efforts are better than others. On the campaign trail Sarah Palin sometimes bragged that she had, as the reforming governor of Alaska, put the state's books online. She did sign the legislation, but the result is a clunky collection of spreadsheets and PDFs.

Even with the best online budgets, the kinks are being hashed out. When Missouri put its government spending database online, in 2007, watchdog groups applauded. The Missouri Accountability Portal was cleanly designed and easy to use. Anyone could log on and see exactly where Missouri's money was going. Kristina Rasmussen of the National Taxpayers Union explored the database and found some suspicious bills. The state had, for example, spent thousands of dollars at Ann's Bra Shop. On inquiry, it turned out that Missouri was buying undergarments for lady inmates. In the future, she reckons, states should figure out a way to put their expenditures in context. The movement itself is full steam ahead. "Smart politicians realise this is a winning issue whether you're on the right or the left," she says.

Indeed, online budgets are especially useful at the moment. One new website, ReadTheStimulus.org, is taking volunteers. They are asked to read a bit of the next spending bill, the American Recovery and Reinvestment Act of 2009, and flag any spending promises that strike them as strange. That may seem like citizens doing the government's job. But at least someone is doing it.



Statewatch: Nevada

Wheel of fortune

Feb 5th 2009 | LAS VEGAS
From The Economist print edition

We begin an occasional series on how America's states are faring in the downturn with Nevada, the ultimate in boom and bust

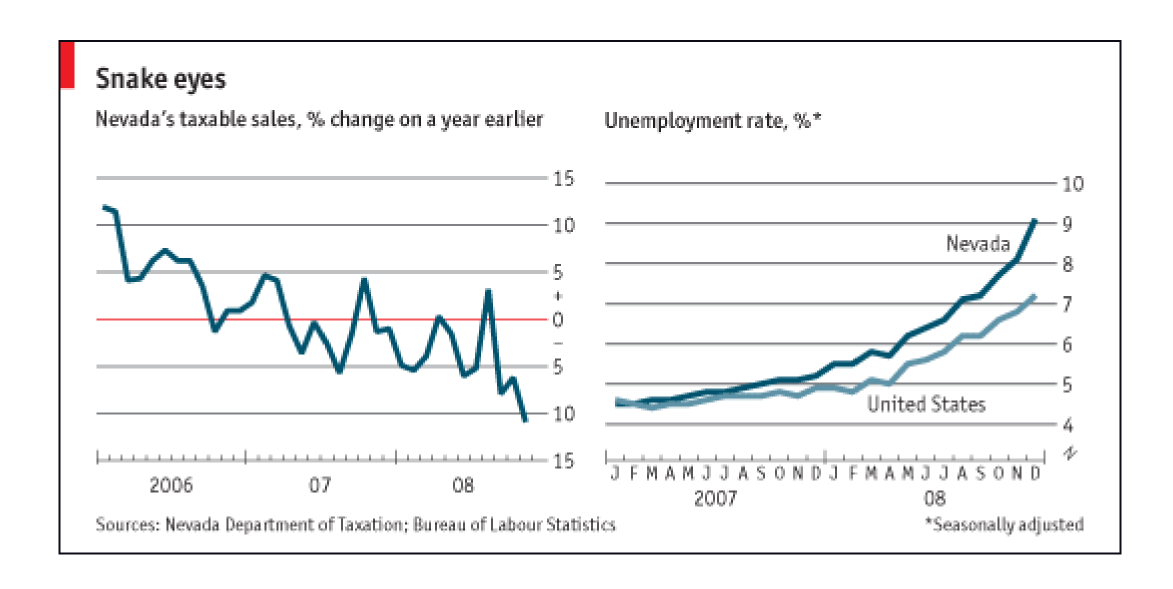


FOR a glimpse of the old, confident Las Vegas, visit its newest hotel. Steve Wynn's vaguely Chinese-themed Encore, which opened in December, is packed with heavy draperies and well-drilled staff. It has thousands of indoor flowers, flat-screen televisions in the bathrooms and a restaurant where the décor changes every half-hour or so. One of its boutiques sells a bejewelled object adorned with a butterfly for $269. Closer inspection reveals it to be a toothbrush-holder.

No doubt it seemed like a good idea two-and-a-half years ago, when work began on the hotel. Today it seems delusional. Nevada's most distinctive industry is slumping as Americans fasten their wallets. Despite the opening of several big casinos, total gambling revenues have declined by 15% in a year. Developers are frantically scaling back projects, or even mothballing them. Still, two huge casino-hotels will open this year, boosting supply at the worst possible moment.

The tourism slump coincides with another, longer-running crisis. Clark County, which includes Las Vegas and 70% of the state's population, suffered America's third-highest foreclosure rate in December, according to RealtyTrac. Property prices in the metropolis have fallen by 41% from their peak and show little sign of stabilising. Tom McCormick of Astoria Homes, the biggest locally-owned builder until the housing collapse made such comparisons moot, says it is not possible to compete with the bank-owned properties flooding the market. As a result, construction has virtually stopped.

Such a quick decline (see chart) would be painful anywhere. In a state with a tradition of boosterism it has caused something of an existential crisis. "We thought the only business cycle was up," laments John Restrepo, a Las Vegas consultant. Perhaps the most shocking news to locals is that Clark County's population, which more than doubled between 1990 and 2007, has declined slightly in the past year.



Yet some boosters remain. "We have the highest foreclosure rate, but that's because we grew so quickly," says Oscar Goodman, Las Vegas's feisty mayor—which is largely true. Mr Goodman disagrees with analysts who say the city will not soon return to double-digit economic growth. He points to plans for yet more casinos and public buildings, including a Mafia museum that is now a symbol of the misuse of federal stimulus money.

Oddly, some of the most pragmatic people in town these days are casino owners. Mr Wynn packed his

new hotel by pricing the rooms cheaply, even though he knew this would force down rates in his other hotels. Expect a further retreat from luxury this year. Las Vegas's nimble hoteliers can replace filet mignon with shrimp cocktail almost as quickly as they can take your money. A focus on low-rollers might seem to be an admission of defeat. Yet it is precisely what the state needs.

During the boom years the exuberance and folly to be seen on the Las Vegas strip were matched by the ludicrous homes that went up in suburban Nevada. Both depended on cheap, available credit; both obscured the state's real strengths. A big reason for Clark County's explosive growth in the past two decades is that it was a great place to be what Americans call middle-class. People moved to the region not for the nightclubs and celebrity chefs but because they could afford a medium-sized house and a garden where they could barbecue almost year-round. And, of course, because there were jobs to be had.

Nevada now needs humdrum jobs more than glitzy casinos. Some promising sources exist. The potential for solar power in southern Nevada is enormous, while northern Nevada has huge geothermal reserves. As Mr Restrepo points out, all those casinos have nurtured gaming developers and lighting designers, who can export their expertise to other states. Reno has turned itself into a distribution hub.

Yet two obstacles stand in the way of economic diversification. The first is Nevada's carefully cultivated reputation for lawlessness. Some whisper that Las Vegas's potent marketing campaign ("What happens in Vegas, stays in Vegas") carries the wrong message to a businessman thinking of relocating from Indiana or Utah.

The second problem is political. Nevada has long been a low-tax, low-services state. But its culture is changing. The working-class Latinos who have moved there, often from California, are less libertarian and keener on public services than older whites. In November voters in Reno and Las Vegas approved an increase in hotel taxes to pay for schools. They also handed control of the state Senate to Democrats for the first time since 1993. The new political majority will need to keep the state attractive to business. The worst outcome for Nevada is that it acquires California's taxes and dismal business climate but not its talent pool or coastal breezes.



Another two bite the dust

Feb 5th 2009
From The Economist print edition

Barack Obama is paying the price for his high-flown rhetoric

Illustration by KAL



ONLY the other day Tom Daschle looked certain to become one of the most powerful people in the Obama administration—simultaneously head of the mammoth Department of Health and Human Services (HHS) and the White House's health-care tsar. Mr Daschle was to be in charge of delivering what Hillary Clinton singularly failed to deliver in 1993-94—a comprehensive reform of America's expensive but ramshackle health-care system.

Mr Daschle's career as a health reformer was killed this week by the revelation, on January 30th, that he had failed to pay $128,000 worth of taxes, mostly relating to a car and driver he had been given use of. At first the Washington establishment assumed that he would ride out the storm. Barack Obama declared his undying support. Mr Daschle pronounced himself "disappointed" by his behaviour. His former colleagues in the Senate competed to praise his public service ("My breast is clear and my support is strong", declared Jay Rockefeller). Then on Tuesday morning Mr Daschle suddenly withdrew his name.

Why the Tuesday surprise? Mr Daschle claims that he read an editorial in that morning's *New York Times* that called for him to step aside, and decided that "I can't pass health care if I'm too much of a distraction." Others whispered that he would have been pushed if he had not decided to jump.

Earlier that very morning Nancy Killefer had withdrawn her candidacy to be the government's first "chief performance officer" because she had failed to pay taxes on a domestic employee. A third nominee in a row with tax problems qualified as a "trend" under an unwritten journalistic law. It also raised issues of gender equality: could Mr Obama allow two men, Tim Geithner (now confirmed as treasury secretary) and Mr Daschle, to get away with tax evasion while allowing a woman to take the rap?

Mr Daschle's disappearance underlines one of the Obama administration's biggest problems: the difficulty of managing the gap between the rhetoric of political campaigns and the reality of governing. All presidential candidates promise to reform Washington. Bill Clinton promised to create "the most ethical administration in history". George Bush promised to put an end to the capital's rancid partisan divisions. But Mr Obama raised the mantra of change to new rhetorical heights.

Throughout two years of high-flown speechifying he promised to clean the Augean stables of Washington, close the revolving door between power and money and raise ethical standards. In his inaugural address, he announced the dawn of a new "era of responsibility"; on his first day in office he unveiled a package of

tight ethical guidelines, though they didn't last long.

The failure of no fewer than three nominees for high office to pay all their taxes has scrambled this message. Aren't liberals supposed to believe that government is a good thing? And aren't people who are being considered to run big departments supposed to be able to run their own financial affairs? (Mr Geithner, who had such trouble understanding the tax code, is now the man in charge of the Internal Revenue Service.) During the presidential campaign, Joe Biden declared that richer Americans had a patriotic duty to pay higher taxes; back in 1998 Mr Daschle opined that "tax cheaters cheat us all, and the IRS should enforce our laws to the letter." Now Democratic insiders were giving the impression that they think that taxes are just for the little people.

But Mr Daschle's problems were deeper than the odd hundred thousand dollars in unpaid taxes. The man from South Dakota was the embodiment of the Washington that Mr Obama campaigned against—a former high-ranking politician who, on losing his Senate seat in 2004, immediately turned himself into an influence-peddler.

He earned more than $2m over the past two years as a "special policy adviser" at Alston & Bird, a law firm which conducts extensive lobbying for health-care companies. He earned $1m a year as a consultant to InterMedia Advisors, a private-equity firm founded by Leo Hindery, a big Democratic donor and the man who gave Mr Daschle the fatal "gift" of car and driver. He raked in $150,000 in 2008 from corporate speeches, many to health-care companies. He was also on the board of the Mayo Clinic, one of the most influential voices in the health-care debate.

The problem for Mr Obama is that, in terms of practical politics, many of Mr Daschle's vices are also virtues. One reason why "Hillarycare" imploded was that Mrs Clinton failed to court the barons on Capitol Hill. Mr Daschle was ideally placed to sell his prospective reforms to his former colleagues in the Senate and the House. Another reason why it failed was that Mrs Clinton failed to pay enough attention to industry groups. Mr Daschle's innumerable entanglements with those groups might have helped to assuage their worries. Mr Daschle was well-versed in the mind-boggling intricacies of health-care reform; his position as both White House insider and head of the department would also have increased the chances of producing a workable reform.

Post-pedestal politics

Mr Obama remains a forbiddingly powerful president, with a 64% approval rating and a Republican Party that is in a shambles. But he is paying a price for his inflated promises. He has already had to give himself a couple of get-out clauses, supporting Mr Geithner despite his problems with his taxes and nominating a former lobbyist for Raytheon to be number two in the Pentagon, one of the biggest-spending departments in the government, in defiance of his own new guidelines.

But the loss of Mr Daschle, one of Mr Obama's closest allies, many of whose former aides hold key positions in the White House, is the heaviest blow so far. And there will be others. The problem with putting yourself on a pedestal is that it is hard to get down from it and engage in the humdrum work of politics.



Hugo Chávez's Venezuela

Oblivious to the coming storm

Feb 5th 2009 | CARACAS
From The Economist print edition

In his first decade Hugo Chávez has presided over social programmes, inflation, crime and rising intolerance. Venezuelans will pay the price in years to come

AP



SQUEEZED between the millionaires' row around the Country Club and the leafy gentility of La Florida, a middle-class neighbourhood, Chapellín is a blemish many of its neighbours would like to see bulldozed. Ten years ago, when Hugo Chávez took office as president of Venezuela, the residents of this Caracas slum would crowd around the gates of the nearby headquarters of Radio Nacional each Sunday. They were there to see but, more important, to petition their leader as he arrived for his weekly radio show.

Mr Chávez celebrates a decade in office this month with a referendum aimed at allowing him to prolong his rule for 20 or 30 more years. The streets of Chapellín are a good place to assess the impact of his self-styled Bolivarian socialist revolution.

“With the arrival of the Revolution,” proclaims an information-ministry press release, “the quality of life of most Venezuelans [has] improved.” That is not the view of Enrique González, a car mechanic. Recently the streets have been cleaner and rubbish collection better, he concedes. But crime, the cost of living and the problem of housing have all worsened substantially since Mr Chávez came to power, he says. The fortnightly shopping for his family “used to cost 100 bolívares [and] now costs 300 ($140),” according to Mr González. “I can't afford to buy what my kids need.” Inflation in 2008 was 31%—the highest in Latin America. Food prices in Caracas rose by almost 50%. The minimum wage is just 800 bolívares a month, although many workers with formal jobs get a bonus of around 250 bolívares for food.

The government's hostility to private property has triggered a shortage of rented housing. Even in rundown Chapellín, a two-bedroom house can cost around 600 bolívares a month. Last year the government began to repair 150 houses affected by damp. But a day of heavy rain flooded most of them and ruined what had been achieved.

Crime has been the main worry of Venezuelan voters ever since the kidnap and murder of three teenage brothers in 2006 dramatised the problem. With almost 15,000 murders in 2008—an increase of two-and-a-half times since Mr Chávez took office—Venezuela has become one of the world's most violent countries.

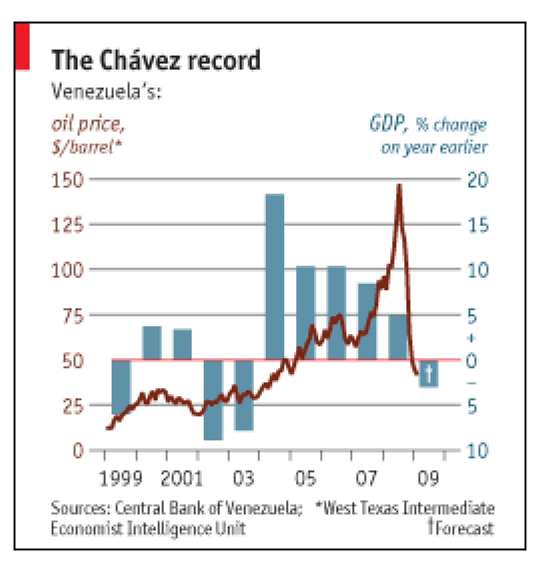
“Just down the street here, a week ago, a man was shot dead by car thieves,” said Jorge Luis Alcalá, a

security guard at a baker's shop in Chapellín. "They didn't even give him a chance to get out of the car." The police do not patrol the area. "They only come when there's a complaint," according to Mr Alcalá.

The barrio is plagued by drug dealers. Your correspondent was offered cocaine—on the main street, in broad daylight—within ten minutes of arriving. "We can't say the police aren't involved," said Yasmín Graterol, a community activist. "The police are certainly involved."

Nevertheless, Ms Graterol defends Mr Chávez's record. She points out that Chapellín now has three soup kitchens to help the poorest, primary health-care posts and a *mercalito* (a government shop with subsidised food). Not far away is an Integrated Diagnostics Centre (CDI), one of the free second-tier clinics set up by the government to offer more sophisticated medical treatment.

José Silva, a 70-year-old taxi driver, is full of praise for the CDI. He hurt his shoulder not long ago, trying to knock ripe mangoes from a tree. "As a pensioner, I get seen immediately," he says. "The Cuban doctor soon fixed my shoulder." Many like Mr Silva are grateful that the president has brought pensions into line with the minimum wage. And although he has to queue for hours at the bank once a month to draw it, he has few complaints.



Mobilising the state

The most reliable opinion polls suggest that Mr Chávez will win the referendum on February 15th, albeit by a small margin. Despite the complaints, just over 50% of respondents in polls approve of him personally. The referendum amounts to a plebiscite on his rule. The tortuous, 75-word question (which does not mention the abolition of presidential term limits) will probably make little difference to the outcome. "People don't care about the articles [to be modified]," says Ms Graterol. "What they have here"—she touches her head—"and here"—the heart—"is Hugo Chávez. They know their leader's future is at stake."

So does Mr Chávez. He has turned almost the whole of the state bureaucracy, including the armed forces and the state oil company, into an election machine. The government-dominated electoral authority has said nothing. Pro-government rallies teem with public-sector workers in red shirts and baseball caps bearing the logos of government departments. "Everyone's here voluntarily," insists Clevis Bozo, who works in the internal audit office of Petróleos de Venezuela (PDVSA), the oil company. "It's the will of the people."

The opposition thinks Mr Bozo and his colleagues would be better employed trying to fix the mess in the oil industry. One reason for what OPEC estimates is a drop in oil output of around 1m barrels per day over the past decade is the politicisation of PDVSA. Venezuela's oil currently fetches below $40 a barrel, down from an average of about $90 last year. Oil accounted for over 90% of Venezuela's exports last year, up from 64% in 1998.

Even so, Venezuela's economic prospects "are relatively comfortable in comparison with other countries in the region, and even the United States," insists Alí Rodríguez, the finance minister. The government claims to have squirrelled away enough to maintain social spending and pay public-sector wages. Since these savings are in unaudited funds, it is hard to judge how long the government can withstand a low oil price without big policy changes. But in a sign that public finances are now under stress, last month it pocketed $12 billion of the Central Bank's $42 billion of reserves.

Many independent analysts, as well as those linked to the opposition, fear economic doom. Five of the country's most prominent economists gave warning that the transfer of reserves to the government's coffers "drastically reduces backing for the bolívar and multiplies the anticipated inflationary impact" of the fall in oil revenues. They predict a squeeze on imports, with a cut of around a third in the foreign currency dispensed by the government's exchange-control watchdog. They expect stagflation, with the economy contracting by 2-2.5% this year and prices rising by more than 40%. The government will be unable to finance its social programmes and will have to devalue, they say.

On the streets, few Venezuelans seem to be aware of these troubles. But the signs are there. PDVSA is months behind with payments to its suppliers, and some drilling rigs have stopped operating as a result.

There are reports that the company is poised to make several thousand of its staff redundant.

In December 2007 Mr Chávez suffered his most serious electoral defeat, when a first attempt to change the constitution to abolish term limits was defeated in a referendum. Since then the government has resorted to large-scale food imports to tackle chronic shortages, which the opposition blames on price controls.

This time the opposition campaign has been weak. It seems exhausted after state and municipal elections last November in which it made important gains. Some opposition supporters assume apathetically that the result will be rigged. “Stand for four or five hours in a queue, so the country can stay the same?” says Mr González, the mechanic. “I don’t think so.”

Harassing the opposition

Mr Chávez has often said that “the revolution is peaceful, but armed.” Violence and intimidation of opponents by the security forces and by armed civilian groups (some openly linked to the government) have increased. Students campaigning against the constitutional change have faced harassment and arrest.

Opposition politicians elected as mayors and state governors last November have found it hard to exercise power. In Caracas the new mayor, Antonio Ledezma, has suffered an occupation of the city hall and other buildings by armed *chavistas*. The government has refused to intervene, saying that the occupations are a response to Mr Ledezma’s refusal to renew the contracts of thousands of workers hired by his *chavista* predecessor. Elsewhere, incoming opposition administrations have also found equipment and offices purloined.

The most disturbing incident was the sacking of Caracas’s main synagogue on January 30th by more than a dozen armed men. They vandalised religious objects, painted anti-Jewish and pro-Palestinian slogans on walls, and stole computer hard drives containing a database of the Jewish community. Officials condemned the attack and blamed the opposition. But it says that the government has been fostering a climate of hostility against Jews. Mr Chávez cut diplomatic ties with Israel in response to its attack on Gaza last month.

Days earlier a group of armed *chavista* radicals had attacked the Ateneo de Caracas, one of the capital’s most important cultural centres. Complaining that it was being used for “ultra-rightist” activities, they hurled tear-gas grenades and fired shots. They held scores of people at gunpoint for hours, stole their mobile phones and vandalised the premises. The assault was lead by Lina Ron, a prominent member of Mr Chávez’s referendum campaign. None of the assailants has been arrested or questioned. As if to dispel any doubt that the invasion of the Ateneo had the government’s support, the next day the finance ministry ordered the eviction of the cultural centre from the state-owned buildings it has occupied since the 1980s.

Ironically, the Ateneo provided Mr Chávez with a platform when he entered politics after leading an unsuccessful military coup against a democratic government in the 1990s. The incident highlights his regime’s increasingly authoritarian bent. “The first thing totalitarian regimes do is to attack institutions where different schools of thought and ideologies come together,” said Carmen Ramia, the Ateneo’s director. Hitherto, to describe Mr Chávez as “totalitarian” has been inaccurate. Will that remain the case?

Uruguay and Argentina

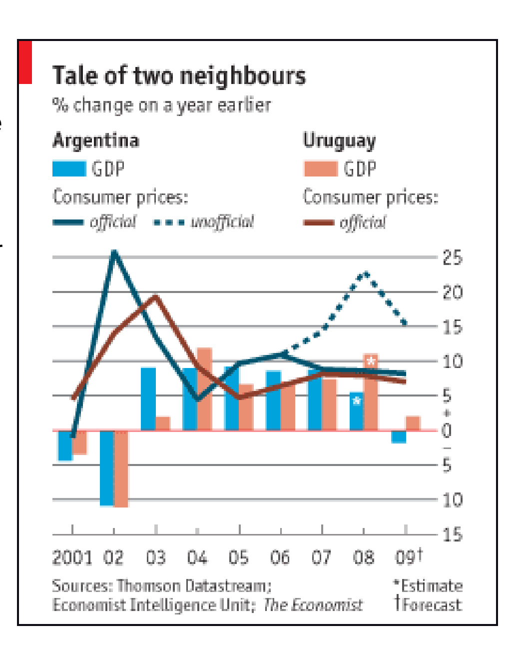
Profiting from virtue

Feb 5th 2009 | BUENOS AIRES AND MONTEVIDEO
From The Economist print edition

Money flows eastwards

URUGUAY, lying just across the muddy waters of the River Plate from Argentina, has been fated in recent decades both to be buffeted by, and to benefit from, its big neighbour's secular instability. Argentina's economic collapse of 2001-2 duly prompted a bank run and recession in Uruguay. While Argentina defaulted on its debt, nationalised foreign businesses and imposed price controls, Uruguay quietly reached an amicable rescheduling agreement with its creditors. It stuck to its orthodox ways even after the leftish Broad Front of President Tabaré Vázquez came to power in 2005. Now it is reaping some benefit.

As a small, open economy dependent on banking, beach tourism and beef exports, Uruguay ought to be more exposed to the world recession than Argentina, with its large domestic market. Both economies have slowed sharply after years of rapid growth. But Uruguay looks set to fare much less badly than Argentina (see chart).



That is because the growth in Argentina owed much to expansionary fiscal and monetary polices which caused the economy to overheat. Over the past year prices for its farm exports have fallen, bringing down tax revenues. To keep public spending going, President Cristina Fernández de Kirchner nationalised the private pension system in October, destroying what little confidence investors had in her government. Argentines, long inured to such behaviour, responded as they always do, by taking their money out. Capital outflows reached 7% of GDP in 2008.

Much of that money went across the river. Deposits in Uruguay's banks by non-residents rose by 41% in the 12 months to December. These pesos follow others: during the presidency of Néstor Kirchner, Ms Fernández's husband and predecessor, some Argentine beef farmers sold their herds rather than submit to export bans and price controls, and ploughed the money into Uruguayan ranches.

Uruguay has ridden out a bitter dispute with Mr Kirchner over a $1.2 billion cellulose factory on its side of the border river. This vast plant, opened last year by Botnia, a Finnish company, added 1.8% to the country's GDP while producing no evidence of the feared pollution which has led Argentine protesters to block a border bridge for the past three years, hurting Uruguay's economy. Mr Vázquez's firm stance spurred other foreign investment.

This will now inevitably slow. But Uruguay is better placed to mitigate recession than its neighbour. Argentina may struggle to roll over the $23 billion in debt maturing this year and next because of investors' distrust: its bonds yield 15 percentage points more than American Treasury bonds. Uruguay is charged a premium of only five percentage points, and can thus more easily afford a fiscal stimulus.

The main source of uncertainty for Uruguay is a presidential election in October. Mr Vázquez cannot stand again. In the Broad Front's primary campaign, his former economy minister and chosen candidate, Danilo Astori, trails José Mujica, a former guerrilla leader who criticises the government as too moderate. But if Mr Mujica is elected as president—and that is far from certain—he is likely to have to govern from the centre. Uruguay may have been outpaced by Argentina earlier this decade, but the tables seem now to have been turned.

A Brazilian political boss

Where dinosaurs still roam

Feb 5th 2009 | SÃO LUÍS
From The Economist print edition

A victory for semi-feudalism

JOSÉ SARNEY first ran for elected office over half a century ago. For the past 40 years he has controlled the fortunes of Maranhão, a state on the eastern fringe of Brazil's Amazon region. He has represented it as federal deputy (twice), governor, and senator (twice). In 1985 he became the accidental, and undistinguished, president of Brazil when the man chosen for the job died before he could take it up. More recently he has been senator for the nearby and newly-created state of Amapá (twice). Time to retire, one might think.

Mr Sarney may look like a throwback to an era of semi-feudal politics that still prevails in corners of Brazil and holds the rest of it back. But with the tacit support of Luiz Inácio Lula da Silva, the country's left-of-centre president, he was this week chosen to preside over the Senate. It is the third time in his career that he has held this powerful job, which confers a degree of control over the government's agenda and opportunities for patronage.

And so it will buttress Mr Sarney's grip over Maranhão just when some locals hoped that this was beginning to crack. The centre of São Luís, the state capital, is decrepit. Some historic buildings are well cared for, such as the gleaming white Church of Our Lady of the Exile. But most are slowly crumbling in the hot, wet weather. The streets are pitted with potholes. An extraordinarily large number of people hang around in the hope of getting a tip in return for showing drivers where to park. In a city of 1m people, there were 38 murders last month alone.

But it is outside São Luís where Maranhão's backwardness is most evident. In Sangue, a town in the interior, many people live in single-room houses, roofed with palm fronds, that lack both running water and electricity. Public transport is scarce. There is nothing much to buy or sell beyond bucketloads of *bacuri*, an Amazonian fruit. Educational achievement across the state is poor. Its infant mortality rate of 39 per thousand live births is 60% higher than the Brazilian average.

Dominance by a single man or family was not uncommon in Brazil's north-east. But it is fading away. The Sarney clan is becoming unusual. Mr Sarney's daughter, Roseana, has been Maranhão's governor and currently represents it in the Senate. His son was a minister in Brazil's previous government. Other relatives are scattered in positions of authority in Maranhão's courts and the civil service. One of his lieutenants, Edison Lobão, is Lula's minister for mines and energy. When he took the job, Mr Lobão's seat in the national Senate went to his son; his wife sits in the lower house. All three of Maranhão's senators answer to Mr Sarney, as do his fellow senators from Amapá.

Reuters



Sarney and Lula, strange allies

This control is aided by the Sarney family's ownership of Maranhão's biggest media company. Its television station transmits the programmes of Globo, which produces Brazil's most popular soap operas. These are interspersed with glowing news reports about the owner's family. Controlling television and radio stations is particularly useful in rural Maranhão, where a majority of the electorate is illiterate and where the Sarneys now draw most of their support. “We are ruled by an electronic oligarchy,” laments Zé Reinaldo, a former state governor.

Even so, the family's power may finally be waning. In 2006 Roseana Sarney lost the gubernatorial election to Jackson Lago. But Mr Lago and his deputy are currently being investigated for electoral crimes. If they are impeached, Ms Sarney will take over as governor once again. In last year's municipal elections, Sarney candidates suffered some setbacks. “Sarney always says that Maranhão must vote for him so he can bring federal money from Brasília,” says Arleth Santos Borges of the Federal University of

Maranhão. “In fact he needs power in Brasília to shore up power here.” That is what the Senate presidency brings him.

Meanwhile Maranhão continues in its sad way. “For fifteen years I have heard Sarney say he will bring development and tourism to Maranhão, but we still have one road in and one road out of this city,” says Hélio, a waiter in São Luís. “And they are both a mess.”

India's election

Awaiting the democratic tide

Feb 5th 2009 | DELHI
From The Economist print edition

With the prime minister recovering from surgery, India is girding itself for a spring election. What sort of government will emerge is anyone's guess

AP



TO UNVEIL preparations for global democracy's greatest logistical feat, an Indian election, representatives of 47 political parties were summoned to Delhi on February 3rd. Sarong-wrapped Tamils, grey-trousered Communists and north Indians in *dhotis*, rough-spun shawls and *kurta-pyjamas*, costumes increasingly rare outside parliament these days, were among them. Absent, alas, were the emissaries of a dazzling new actor-politician, Chiranjeevi—an immortal of "Tollywood", the Telugu-language film industry of Andhra Pradesh—as election officials ran through arrangements for a poll that is expected to begin in April, extend over several weeks, and for which nearly 700m voters have been registered.

Adding to the drama was an ugly row between two of the officials themselves. N. Gopalaswami, head of India's Election Commission, has been trying to sack his deputy, Navin Chawla, whom he accuses of bias in favour of the Congress party, which leads India's ruling coalition. With Mr Chawla expected to take over from Mr Gopalaswami when he retires in April, Congress's main opponent, the Bharatiya Janata Party (BJP), is predictably enraged. But Congress insists that Mr Chawla, an acolyte of its former leader, Indira Gandhi, stay put. Some fear the spat augurs an ill-tempered—even unjust—election.

India's two main parties were already nervy. As at the pre-poll meeting, they find themselves in an increasingly crowded arena. Neither has a hope of winning an outright majority in the election. After decades in decline, Congress cobbled together a government in 2004 after winning 145 of a possible 543 seats—the lowest winning tally in any Indian election. Yet neither of the parties can be confident of beating this score. So, as important as the election's outcome will be their subsequent race to recruit allies among the proliferating regional, caste-based and leftist parties. If neither of the big parties musters a majority that way, India's next ruling coalition may even emerge from this horde.

Compared with the Hindu nationalists, Congress in fact seems quite perky. The reason why is not obvious. At the end of a five-year term, dominated by a booming economy, including a run of annual economic growth of 9%, the government has hit trouble. The economy is slowing; the IMF has forecast GDP growth of 5.6% in the financial year ending in April. Thousands of jobs have already been lost. The terrorist atrocity in Mumbai last November has also spread gloom. And the party's septuagenarian prime minister and acting finance minister, Manmohan Singh, is incapacitated: off work for a month after undergoing heart bypass surgery on January 24th. In fact his absence has not caused much obvious disruption: a sign of how constrained he has been, at the helm of a massive and feuding coalition.

A result close to its 2004 performance would be creditable for Congress. It is likely to retreat in Andhra Pradesh, the state where it won most seats in 2004, and where the emergence of a new party under Mr Chiranjeevi, a star of 148 Telugu and Hindi films, will further divide the vote. Congress will hope to make good in, for example, Kerala, Rajasthan and Punjab. It needs to, since the prospects of some of its allies elsewhere are even worse. In Bihar and Tamil Nadu, Congress's two biggest regional allies look set for a beating. The Communists, whose "outside" support propped up the government until they stalked away last year, are also expected to fare worse than in 2004. Partly to leave the door open for fresh "post-poll" alliances, after the votes are counted, Congress announced on January 29th that it would fight the election solo; though, as in 2004, it will form alliances state by state.

Mr Singh's health is a worry for Congress. A conciliatory figure, he has been much criticised for his gentle leadership. Yet he has been more evident in recent months, securing the passage of a vaunted nuclear co-operation deal with America, and saying shrewd things about the world economy. Congress's leader, Sonia Gandhi, who passed up the job of prime minister five years ago to forestall controversy over her foreign (Italian) birth, would like the loyal Mr Singh to remain prime minister until her gauche 38-year-old son, Rahul, is considered up to the job. If Mr Singh could not dust himself off for another year or two at the helm, it is not clear to whom Mrs Gandhi might turn.

The BJP also has leadership worries, but they go deeper. Shattered to lose power in 2004, the party has since been riven by feuding between its two main constituents, Hindu ideologues and secular free-marketeers. A string of state-election victories, and the nomination last year of L.K. Advani, a doughty octogenarian, as its prime-ministerial candidate had seemed to reverse the party's decline. But after some disappointing state-election results in December, and recent incidents of terrorism and vigilantism by Hindu fundamentalist thugs, the party's ideological chasm has reopened. And Mr Advani, despite launching a slick new blog, is suddenly seeming his age. The BJP rank-and-file, as well as many Indian industrialists, would prefer to follow Narendra Modi, a charismatic, fire-eating Hindu-chauvinist and chief minister of Gujarat, who has a reputation for efficient economic management, but was implicated in a pogrom against Muslims in 2002. If not in this election, Mr Modi's time may come.

On current form, the BJP's electoral prospects look no better than Congress's, which probably explains why its rival seems oddly chipper. The logic of anti-incumbency, a rule of thumb in predicting Indian elections, suggests the Hindu nationalists will decline in several northern bastions, including Rajasthan and Chhattisgarh. They must also fear a wipe-out in Uttar Pradesh (UP), a giant northern state with 80 parliamentary constituencies, which played a big part in propelling them to power in the 1990s. The BJP fared miserably in UP's 2007 state election, which was swept by the Bahujan Samaj Party, an outfit dedicated to *dalits*, Hinduism's former "untouchables", and led by a mercurial and scandal-prone woman, Mayawati.

To the joy of some 250m *dalits*, and the consternation of almost everybody else, Miss Mayawati hopes to claim the prime ministership for herself. She is one of two poles around which a non-Congress, non-BJP government might emerge. The other is a coalition of irritated former allies of both Congress and the BJP, including Communists and regionalists, and known as the "third front". A currently fashionable theory is that, if both big parties do as modestly as many expect, Congress could choose to lend its parliamentary votes to such a government, rather than lead a weak administration in troubled times. What good this unstable arrangement might do India is rather hard to grasp.


WORLD
ASIA

Malaysia's airport controversy

Terminal declined

Feb 5th 2009 | KUALA LUMPUR
From The Economist print edition

Less a setback for a budget airline than a blow to the government's credibility

Reuters



Looking for a cheap parking place

IT WAS billed as the people's airport, a M$1.6 billion ($440m) international gateway to be owned and operated by AirAsia, Malaysia's ambitious budget airline. Private land had been found, close to Kuala Lumpur International Airport (KLIA). Malaysia's cabinet had given its approval. But a chorus of whines from politicians, pundits and the state company that owns KLIA (and knows a competitor when it sees one) have clipped AirAsia's wings. The government now insists the carrier must stay at KLIA, which has promised to build it a new terminal. Sime Darby, the oil-palm company that owns the land, has been forced to drop its plans. As policy flip-flops go, this takes some beating.

What in effect killed AirAsia's plans was the intervention on January 30th of Najib Razak, the deputy prime minister. The fiasco has exposed the wavering grip on power of Abdullah Badawi, the lame-duck prime minister, who is to be succeeded by Mr Najib in March. Mr Najib is a protégé of Mahathir Mohamad, prime minister for 22 years until 2003, who had been among the shrillest critics of the project.

AirAsia, however, may yet have the last laugh. So far, its trajectory has been relentlessly upward. It launched in 2002 with two leased planes. It currently has 76 aircraft, including the first batch of 25 Airbus A330s on order for AirAsia X, its long-haul subsidiary. Last year it carried 19m passengers within Asia and the Pacific. Of these, around 10m shuffled through KLIA's satellite low-cost carrier terminal, a converted cargo facility opened in 2005. AirAsia forecast that by 2011 it would exceed the terminal's capacity of 15m passengers. It is already short of parking bays for its aircraft, and was looking for an alternative.

Tony Fernandes, the bullish chief executive, says that his dream of a new airport was born out of frustration with Malaysia Airports, KLIA's operator, which is controlled by Khazanah Nasional, the government's investment fund, as is Malaysia Airlines, the national flag-carrier. Last year Mr Fernandes wrote on his company website that a new airport by 2011 was a matter of life or death for AirAsia. Opponents of the project argued that a rival airport could be the kiss of death for KLIA, which opened in 1998, caters for around 25m passengers a year and aspires to be a regional hub. A private airport would inevitably require public infrastructure spending. Moreover, Malaysia's capital is already served by three airports. To build a fourth seems a mite extravagant.

Critics say that a stronger government would have made a decision one way or the other and stuck to it. As it is, taking the project away from a successful private firm, AirAsia, and giving it to a government-owned monopoly hardly seems reason for cheer. AirAsia has delivered huge benefits to Malaysia by bringing in foreign tourists, creating jobs and cutting the cost of air travel. It aims to carry 60m passengers by 2013. It is already Malaysia Airport's biggest customer. Yet instead of rolling out the red carpet for it, the authorities seem to be trying to pull the rug out from under it.

AirAsia did, however, win concessions from Mr Najib. Officials say these include a say in the design, cost and operation of the planned new terminal. Mr Fernandes declined to comment. Like all budget carriers,

AirAsia wants to pare costs, which is why it refuses to berth its planes at KLIA's expensive glass-and-steel terminal. A properly equipped terminal with a low service charge would do nicely. Indeed, access to such a terminal may have been AirAsia's intention all along. Its threat to build a private airport managed to put some pepper on the tail of policymakers, says Peter Harbison, of the Center for Asia Pacific Aviation in Sydney. A bit drastic, but effective. Last year Malaysia Airports reportedly told AirAsia it would take four years to build a terminal. The new deadline is 2011. Amazing what competition can do.



Malaysia's airport controversy

Terminal declined

Feb 5th 2009 | KUALA LUMPUR
From The Economist print edition

Less a setback for a budget airline than a blow to the government's credibility

Reuters



Looking for a cheap parking place

IT WAS billed as the people's airport, a M$1.6 billion ($440m) international gateway to be owned and operated by AirAsia, Malaysia's ambitious budget airline. Private land had been found, close to Kuala Lumpur International Airport (KLIA). Malaysia's cabinet had given its approval. But a chorus of whines from politicians, pundits and the state company that owns KLIA (and knows a competitor when it sees one) have clipped AirAsia's wings. The government now insists the carrier must stay at KLIA, which has promised to build it a new terminal. Sime Darby, the oil-palm company that owns the land, has been forced to drop its plans. As policy flip-flops go, this takes some beating.

What in effect killed AirAsia's plans was the intervention on January 30th of Najib Razak, the deputy prime minister. The fiasco has exposed the wavering grip on power of Abdullah Badawi, the lame-duck prime minister, who is to be succeeded by Mr Najib in March. Mr Najib is a protégé of Mahathir Mohamad, prime minister for 22 years until 2003, who had been among the shrillest critics of the project.

AirAsia, however, may yet have the last laugh. So far, its trajectory has been relentlessly upward. It launched in 2002 with two leased planes. It currently has 76 aircraft, including the first batch of 25 Airbus A330s on order for AirAsia X, its long-haul subsidiary. Last year it carried 19m passengers within Asia and the Pacific. Of these, around 10m shuffled through KLIA's satellite low-cost carrier terminal, a converted cargo facility opened in 2005. AirAsia forecast that by 2011 it would exceed the terminal's capacity of 15m passengers. It is already short of parking bays for its aircraft, and was looking for an alternative.

Tony Fernandes, the bullish chief executive, says that his dream of a new airport was born out of frustration with Malaysia Airports, KLIA's operator, which is controlled by Khazanah Nasional, the government's investment fund, as is Malaysia Airlines, the national flag-carrier. Last year Mr Fernandes wrote on his company website that a new airport by 2011 was a matter of life or death for AirAsia. Opponents of the project argued that a rival airport could be the kiss of death for KLIA, which opened in 1998, caters for around 25m passengers a year and aspires to be a regional hub. A private airport would inevitably require public infrastructure spending. Moreover, Malaysia's capital is already served by three airports. To build a fourth seems a mite extravagant.

Critics say that a stronger government would have made a decision one way or the other and stuck to it. As it is, taking the project away from a successful private firm, AirAsia, and giving it to a government-owned monopoly hardly seems reason for cheer. AirAsia has delivered huge benefits to Malaysia by bringing in foreign tourists, creating jobs and cutting the cost of air travel. It aims to carry 60m passengers by 2013. It is already Malaysia Airport's biggest customer. Yet instead of rolling out the red carpet for it, the authorities seem to be trying to pull the rug out from under it.

AirAsia did, however, win concessions from Mr Najib. Officials say these include a say in the design, cost and operation of the planned new terminal. Mr Fernandes declined to comment. Like all budget carriers,

AirAsia wants to pare costs, which is why it refuses to berth its planes at KLIA's expensive glass-and-steel terminal. A properly equipped terminal with a low service charge would do nicely. Indeed, access to such a terminal may have been AirAsia's intention all along. Its threat to build a private airport managed to put some pepper on the tail of policymakers, says Peter Harbison, of the Center for Asia Pacific Aviation in Sydney. A bit drastic, but effective. Last year Malaysia Airports reportedly told AirAsia it would take four years to build a terminal. The new deadline is 2011. Amazing what competition can do.

Australia's economic stimulus

Hey, big spender

Feb 5th 2009 | SYDNEY
From The Economist print edition

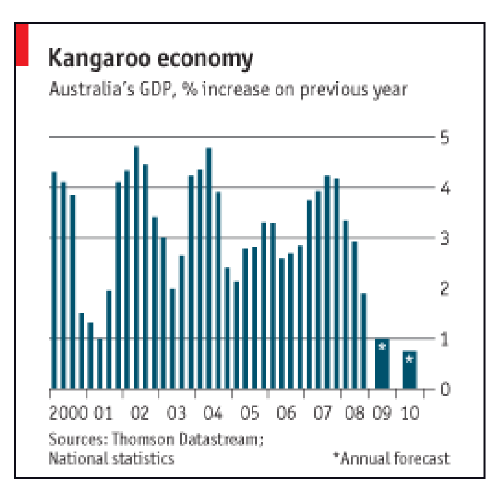
Kevin Rudd shops for a recovery

HAVING inherited a booming economy when he led Australia's Labor Party to power in late 2007, Kevin Rudd predicted optimistically last October that his country would avoid a recession during the global downturn. Now he is sounding more worried, and acting more defensively. This week he announced a stimulus package worth A$42 billion ($27 billion), one of the biggest in the country's history. The government, he declared, would "move heaven and earth" to keep the economy growing. Barely a corner of Australian life will be untouched by the spending spree.

Yet there is no guarantee it will achieve its aim. The immediate trigger for the stimulus was a Treasury report that the global recession had slashed A$115 billion from forecast revenue up to 2012. While six of Australia's top ten export markets are already in recession, the chief impact has come from the slowdown in one that is not: China, its biggest trading partner, and the main driver of a minerals boom that has fed fat company-tax revenues. Such booms have worked magic to keep "the lucky country" out of trouble before. But not now. Lindsay Tanner, the finance minister, cites figures showing how much Australia had come to depend on such revenues, and the shock when they abruptly fade away: at the latest boom's peak, company taxes had grown to a quarter of federal revenue, from just 9% in the mid-1980s.

Growth forecasts for 2008-09 have now slid from 2.75% in last May's budget to 1%, and to just 0.75% for next year. Mr Tanner concedes such figures are a bit "anaemic", but says the chances of staying out of recession are still "reasonable". Some economists are less optimistic. The test will be whether Mr Rudd's stimulus has the right targets. About a third will go in cash handouts of almost A$1,000 each to encourage low- and middle-income workers, farmers and students to spend. A similar stimulus of A$10.4 billion late last year seems to have worked: after two months of weak demand, it helped push retail spending in December up by 3.8%.

But the bulk of Mr Rudd's stimulus, almost A$30 billion, will go on infrastructure: new school buildings, road repairs and house insulation. And more is on the way. A body Mr Rudd appointed under Sir Rod Eddington, a businessman, is due to report soon on much bigger demands for public cash, such as for railways, ports and energy grids. Already, the revenue slump and stimulus spending have ended more than a decade of budget surpluses; the latest estimates project combined deficits of A$118 billion over the next four years.



On January 31st Mr Rudd prepared the ideological ground for this shift with a much-discussed article in the *Monthly*, a magazine. He blamed the global crisis on neoliberalism, or "free-market fundamentalism—and excessive greed". Social democracy, he wrote, must now "prevent liberal capitalism from cannibalising itself". This was also about claiming the political high ground. Mr Rudd accused the Liberal Party, the main opposition party, which ruled for 11 years before the crisis, of being Australia's neoliberals. Malcolm Turnbull, the Liberal leader, wants tax cuts, not public spending, to boost the economy, and opposes the stimulus package.

The central bank cut interest rates by a percentage point to a cash rate of 3.25% on the day Mr Rudd announced his stimulus, the fifth cut since September. Glenn Stevens, the bank's governor, says the monetary and fiscal changes will help to "cushion" the economy. If Australia nonetheless goes into recession, Mr Rudd and Mr Turnbull will keep trading charges on who is to blame: neoliberals or big spenders.

Ideological debate in China

The Little Red Bookshop

Feb 5th 2009 | BEIJING
From The Economist print edition

Whose little-read leftist texts may be coming back into vogue

Illustration by Claudio Munoz



IN A small bookshop on the ninth floor of an office and residential building in Beijing's university district, the staff wear Mao badges. Works extolling the late Chinese leader, damning capitalism and attacking globalisation are laid out on shelves. Scour the "non-mainstream economists" section for some of the most popular ones. Staples of most bookshops—volumes on how to succeed in business, play the stockmarket or get into an American university—are not on sale.

The Utopia bookshop is a refuge for China's leftists, the term used to describe those nostalgic for Mao Zedong's rule and worried that the country is abandoning its communist principles. This is the place to buy the selected writings of Mao's late widow, Jiang Qing, and other members of the Gang of Four who were imprisoned after the chairman's death. A three-volume critique of China's property law, enacted in 2007 and much disliked by leftists because of its supposed bias in favour of private-property ownership, goes for 200 yuan ($30).

A bookshop manager says the global economic crisis is proving good for business. More in China are beginning to question "mainstream" economic thinking that favours open markets and private enterprise. "Liberalism is bankrupt. Lots of mainstream economists have nothing to say now," says a Utopia regular.

The bookshop's owner, Fan Jinggang, says its website has helped too. It includes Utopia's fortnightly newsletter, the latest edition of which carries an article accusing Western countries of trying to make China "the biggest sacrificial victim" of the economic downturn and describing China's liberal economists and political thinkers as the West's "running dogs". The article's author, Zhang Hongliang, is the director of a securities-research institute at Minzu University in Beijing.

Utopia, which opened about six years ago (in a different part of Beijing), is one of a handful of private bookshops in the capital to invite intellectuals to give lectures. The first of its kind, Sanwei Bookstore, opened in 1988 and has been host to many controversial speakers of the kind that frequenters of Utopia love to hate. In December a veteran Chinese journalist, Yang Jisheng, addressed a crowded upstairs room on the subject of the famine unleashed by Mao's "Great Leap Forward", in which, Mr Yang believes, 36m people died.

The authorities watch warily. In his talk Mr Yang avoided a question from the audience about the broader political lessons to be drawn from the famine. But at Utopia, Mr Zhang of Minzu University spoke enthusiastically a few days later (copies available on samizdat CDs) about an important recent speech by Hu Jintao, the president and Communist Party leader. Mr Hu, he noted, had omitted the party's usual warning about the need to prevent leftism. The left spots a political opening—if only, so far, on the shelf.



Press freedom in Kazakhstan

Keep it official

Feb 5th 2009 | ALMATY
From The Economist print edition

Independent blogging under threat

COMPARED with his cabinet colleagues, Karim Massimov, Kazakhstan's prime minister, is a digital whizz-kid. When he took the job two years ago he already had his own website. Last month he flaunted both his technical know-how and his flair for self-promotion by emerging as the country's top blogger. He launched his personal blog, as an online forum for citizens to raise their concerns, and ordered his ministers to do the same.

The new blog may bring the government closer to the people, as intended; or it may turn out to be no more than a clever public-relations stunt. Already, citizens have started posting appeals on the blog. Mr Massimov has even raised a few in his official meetings. But if a draft law now before parliament is passed, other bloggers in Kazakhstan risk being shut down. More than a dozen newspaper editors and activists, saying it would lead to censorship, have signed an appeal for its withdrawal.

The timing of the new law is odd. It would impose stricter control over all internet traffic, including chat rooms, as well as individual bloggers. Yet it was tabled in parliament only two weeks after MPs amended the media law in, by local standards, a relatively liberal way. That was one of several legislative changes aimed at meeting Kazakhstan's promise to improve its much-derided democratic credentials before taking over the rotating chairmanship of the Organisation for Security and Co-operation in Europe (OSCE) in 2010.

Yurii Mizinov, editor-in-chief of zonakz.net, a popular website, believes the draft internet law has a limited aim—to prevent one person, the widely despised Rakhat Aliyev, a former son-in-law of President Nursultan Nazarbayev, from spreading embarrassing material. Mr Aliyev was last year sentenced in absentia to 40 years in prison by Kazakhstan's courts for crimes including staging an attempted coup and kidnapping. In self-imposed exile in Austria, he enjoys discomfiting senior Kazakhstani officials by putting secretly obtained recordings of their conversations on the web. He is thought to have a whole archive of such tapes at his disposal.

Whatever its purpose, the draft law would make life even harder for the press. Being an independent journalist in Kazakhstan is tough enough as it is. On December 30th one was stabbed three times in front of his house in Almaty; another was beaten up in January. And a court slapped a big fine on an opposition newspaper for slandering a parliamentarian.

Seitkazy Matayev, chairman of Kazakhstan's journalists' union, says the authorities have realised they made a mistake five years ago when they started to computerise all the country's schools and to provide them with internet access. They now worry about a new generation of outspoken internet users. However, Mr Matayev remains defiantly hopeful they cannot be effectively silenced: "The only way to control the internet in Kazakhstan is to turn off the electricity in the whole country."

Myanmar and the United Nations

Knock, knock

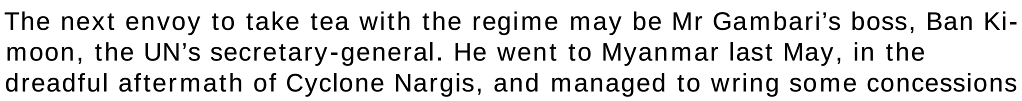
Feb 5th 2009
From The Economist print edition

As usual, the UN finds no one at home in the junta to discuss political reform

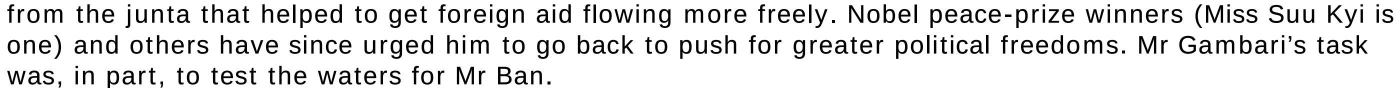

AFP

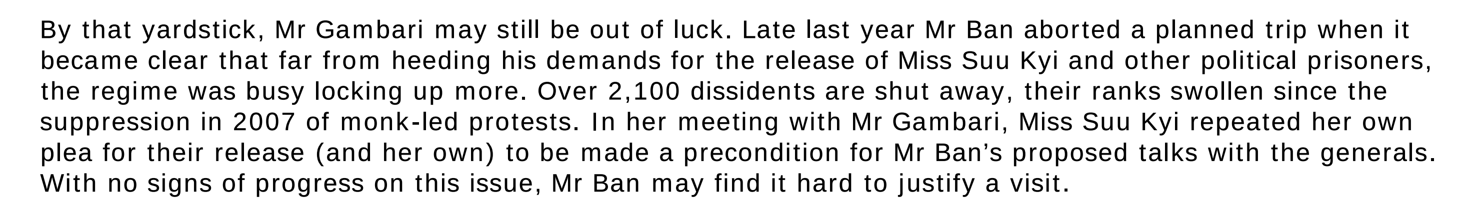
AT LEAST he tried. That is probably the best that could be said for Ibrahim Gambari's latest mission to Myanmar, which ended on February 3rd. The four-day visit was the Nigerian's seventh as the United Nations' envoy to the country, a job whose history is strewn with past failures.

On this trip, unlike his visit last August, Mr Gambari was able to see Aung San Suu Kyi, the detained leader of the opposition. He spent over an hour with her and with executives from her moribund National League for Democracy. General Than Shwe, however, the junta leader, was unavailable, as so often when the agenda is political reform. Instead, the job of stonewalling Mr Gambari fell to General Thein Sein, the prime minister. State television reported that the prime minister had asked for the lifting of sanctions on Myanmar as a precursor to "political stability".



The next envoy to take tea with the regime may be Mr Gambari's boss, Ban Ki-moon, the UN's secretary-general. He went to Myanmar last May, in the dreadful aftermath of Cyclone Nargis, and managed to wring some concessions from the junta that helped to get foreign aid flowing more freely. Nobel peace-prize winners (Miss Suu Kyi is one) and others have since urged him to go back to push for greater political freedoms. Mr Gambari's task was, in part, to test the waters for Mr Ban.





By that yardstick, Mr Gambari may still be out of luck. Late last year Mr Ban aborted a planned trip when it became clear that far from heeding his demands for the release of Miss Suu Kyi and other political prisoners, the regime was busy locking up more. Over 2,100 dissidents are shut away, their ranks swollen since the suppression in 2007 of monk-led protests. In her meeting with Mr Gambari, Miss Suu Kyi repeated her own plea for their release (and her own) to be made a precondition for Mr Ban's proposed talks with the generals. With no signs of progress on this issue, Mr Ban may find it hard to justify a visit.

The Bush administration's answer to Myanmar's bad behaviour was to tighten economic sanctions. Indeed, two more of the junta's cronies were added to a Treasury blacklist days before Mr Bush left office. Few expect the new administration to change tack. Myanmar's exiled democracy camp may point to the prime minister's complaint to Mr Gambari as evidence that sanctions are biting. But Western diplomats in Asia are sceptical of their leverage over Myanmar, as long as Asian powers stand by their neighbour.

Western donors had hoped that international cyclone relief would crack open the door to broader co-operation on aid, and perhaps a dash of *glasnost*. There is little sign that it did. The World Food Programme recently reported that Myanmar will need 185,000 tonnes of food aid this year, after the cyclone and a rat infestation have ruined crops. But its ability to deliver grain to the needy is strangled by the junta's controls, particularly in desperately poor western Myanmar.

The Association of South-East Asian Nations (ASEAN) played a useful role last year in channelling cyclone aid into Myanmar. But ASEAN is not prepared to cause a political controversy, despite its recent adoption of a charter that pays lip-service to human rights. Not all its members, which include autocratic regimes such as Vietnam and Laos, are convinced that political freedoms are such a good idea. Myanmar's frustrated democrats face the choice of holding their nose to contest elections due to be held next year under a constitution entrenching the army's political role, or sticking to their principles and boycotting a poll that may well be a sham but the only hope of change on offer.



WORLD ASIA

North Korea's belligerence

In the court of King Kim

Feb 5th 2009 | SEOUL
From The Economist print edition

The dictator's bluster falls on deaf ears in South Korea and, worse still, in America

IF HIS spooks in Seoul dare tell him the truth, then North Korea's dictator, Kim Jong Il, knows that all his threats against South Korea and its president, Lee Myung-bak, have made little impression. Since his inauguration a year ago, Mr Lee has made it clear that he will engage properly with the North only when it really begins to dismantle its nuclear capability.

Reuters



Mr Kim with Chinese cheese and Dutch courage

The stand has infuriated Mr Kim. For months he has abused the South Korean government. He has threatened it with "all-out confrontation". In December North Korea expelled most South Korean officials from the Kaesong industrial complex, a symbol of economic co-operation. In late January it repudiated a 1991 agreement on reconciliation, non-aggression and co-operation between the Koreas. It says it will no longer honour the western maritime boundary between the two countries, known as the northern limit line, long disputed by the North. This week South Korea's press reported that the North Korea seemed to be making preparations to test-fire its Taepodong-2 missile, whose theoretical range of 6,700 kilometres (4,200 miles) would reach Alaska.

In a televised discussion, Mr Lee dismissed the threats as "not new". Ordinary South Koreans seem equally impassive, although South Korea's navy takes seriously the possibility of another clash in the Yellow Sea—the last, deadly, one was in 2002. Choi Kang at the Institute of Foreign Affairs and National Security, a think-tank, predicts that the North will test South Korean resolve to defend the northern limit line.

Mr Kim's bluster is probably intended more for an American audience than a South Korean one—as well as for his own people. After an illness last year, the 66-year-old may want to show his grip on the country. Rallying North Korea's army to his side by (verbally) attacking South Korea is an old trick of Mr Kim's. What is more, says Ren Xiao of Fudan University in Shanghai, North Korea feels "marginalised" by America, as President Barack Obama's new administration gets to grips with a daunting agenda. Through brinkmanship, says Mr Ren, North Korea is reminding America of its existence and, it thinks, putting pressure on it to change its supposedly hostile policy. If there is one thing the tinpot dictatorship hates, it is to be ignored.

Like any thrower of hissy fits, the North can switch on the charm, too. At a banquet in Pyongyang last month for a big Chinese Communist Party cheese, Mr Kim assured his guest that he was making efforts to denuclearise the Korean peninsula.

Han Sung-joo, a former South Korean foreign minister, now at the Asan Institute, a think-tank, says that this behaviour is to be expected. North Korea regularly seeks to show a smiling face to China and

America, while keeping a stern one for the South. It is incensed that Mr Lee's administration will not discuss honouring inter-Korean agreements signed by Mr Kim when he met with then South Korean Presidents Kim Dae-jung and Roh Moo-hyun, in 2000 and 2007 respectively.

Both these presidents were also the targets of abuse at the start of their five-year terms, before historic meetings with the Dear Leader. Mr Lee may yet have such a summit too. For now, time is on his side. Last month he named Hyun In-taek, the architect of his tougher strategy towards North Korea, to run the unification ministry, which traditionally conciliates the North. The president promises massive aid and investment, with the aim of raising North Korean income per head to $3,000 a year within a decade, if only the North gives up its atom bombs. As Mr Lee sees it, the ball is firmly in Mr Kim's court.

Israel

Politics not quite as usual

Feb 5th 2009 | JERUSALEM
From The Economist print edition

Enter an ultra-dark horse in the country's upcoming elections

AP



A THREE-HORSE race for much of the campaign, the Israeli election due on February 10th has a new hopeful. It is now a four-horse affair, with a long trail of also-rans. According to the polls, Yisrael Beitenu, previously a minor right-wing party led by Avigdor Lieberman, has been doing surprisingly well. So much so, in fact, that Mr Lieberman is up there with the more familiar parties and their leaders: the Likud under Binyamin Netanyahu, Kadima under Tzipi Livni and Labour under Ehud Barak. The front-runner remains Mr Netanyahu, but he seems likely to win with fewer than 30 seats, just one-quarter of the 120-seat Knesset. The prospect, therefore, after some tortuous post-election horse-trading, is for a fragile coalition, with its many components pulling in different directions.

Mr Lieberman, the dark horse, is branded by the left as racist, even fascist. He wants Israeli Arabs, nearly 20% of the population, to pledge allegiance to the state and be required to do military or national service. "No loyalty—no citizenship" is one of Yisrael Beitenu's election slogans, along with "Only Lieberman understands Arabic". He also proposes a repartition of Palestine so that areas of Israel with large Arab populations can be transferred to the Palestinian Authority in return for areas of the West Bank settled by Jews. The Arab communities in question are unanimously and vehemently opposed to the plan.

Mr Lieberman is drawing voters away from the Likud, which means a narrowing of the gap between the Likud and Kadima, the centrist party founded in 2005 by Ariel Sharon and now led by Ms Livni. She is appealing to supporters of Labour and the myriad little parties of the left to come over to Kadima and help her pip Mr Netanyahu at the post. Pundits doubt she will succeed. And even if she does, they point out, the rightist block—the Likud and all the nationalist and religious parties round it—seems unbeatably bigger than the left.

Victory, then, to Mr Netanyahu and his allies? Not so fast. Mr Lieberman, who began his public career as Mr Netanyahu's aide, has not said he will back him as prime minister. Yisrael Beitenu's supporters demand the legalisation of civil marriage and other measures to loosen the statutory grip of the rabbis on the laws governing Israelis' personal lives. Mr Netanyahu's Orthodox allies, and the many traditionalists inside his own Likud, would balk at some of that agenda. Ms Livni, however, would embrace it.

More important, the Likud leader, still chastened by an unhappy first spell as prime minister in the 1990s

at the head of a right-religious coalition, is determined this time to present a more moderate profile to the world, and especially to the Obama administration. Ideally, he wants Labour in his coalition, with Mr Barak staying on as defence minister. The voters might applaud. A “unity government” is the perennial favourite in Israeli opinion polls, and Mr Barak, in high regard at home after the pummelling of Gaza, is now the most desirable defence minister in such a putative dream team.

Likud strategists believe Kadima would not survive opposition. They hope it would split, with Likud renegades coming home to Mr Netanyahu and former Labour supporters making their way back to Mr Barak. This would be good for politics in general, they piously add, restoring the Likud and Labour to their pristine places as the two big parties of the right and the left. Coalitions would become more manageable, governments more durable and the country more governable.

Reuters



Mr Lieberman struts his stuff

Meanwhile, though, a police investigation against Mr Lieberman for bribery and money-laundering will complicate the coalition haggling after this election. Mr Lieberman cannot be minister of internal security while under investigation, says the attorney-general, nor minister of justice. Could he be minister of finance? If not, what job could Mr Netanyahu offer him?

In Gaza, meanwhile, a desultory exchange of militants’ rockets and Israeli bombs goes on, nearly three weeks after Israel and Hamas made their separate ceasefire announcements. Most of the rockets have been of the short-range variety, though on February 3rd a Katyusha missile struck Ashkelon, causing damage but no casualties. Most of Israel’s bombing has been aimed at the smugglers’ tunnels under the Egypt-Gaza border at Rafah.

Mr Barak says he is reining in Israel’s response to the rockets pending the outcome of talks in Cairo between Hamas and Egyptian officials on a long-term ceasefire. Israel wants the Palestinian Authority, and not Hamas, to supervise access to the Gaza Strip, and looks to Egypt, with the help of America and European countries, to stop the subterranean smuggling.

The unconcluded Gaza war and the election are intertwined in voters’ minds and candidates’ speeches. Hamas, Mr Barak insists, is “hard hit and broken. But the rockets are facts and you can’t ignore facts. If it needs another blow, make no mistake—we’ll deliver one.” Ms Livni, anxious to sound no less macho, urges tougher retaliation. Mr Netanyahu says the war ended too soon. It remains to be seen which party will benefit most from the continuing drizzle of rockets and reprisals.

Voting in Iraq

God takes a back seat

Feb 5th 2009 | BAGHDAD
From The Economist print edition

Encouraging signs from the country's provincial elections



THERE were, perhaps inevitably, a few reminders of the country's recent past. Allegations of foul play threatened a return to violence in Anbar province, for instance, once the heart of Iraq's Sunni-led insurgency. Tribal sheikhs there accused incumbent Sunni politicians of rigging the polls. But for a few incidents, though, the voting was largely peaceful in all 14 of the provinces that held local elections on January 31st (four did not). That alone is being hailed as a great success.

The comparison with the polls in 2005 certainly offers hope. The threat of terrorism then made it too dangerous to deploy any foreign monitors. This time observers were present in all 712 voting districts. In 2005 more than 200 candidates were killed; this time only eight died. That is progress, Iraqi-style. Peaceful polls were seen as essential if America's 142,000 troops were to start pulling out. After the vote, President Barack Obama indicated that he plans to bring a "substantial" number of troops home over the next 12 months.

As to the results, first returns showed that allies of Nuri al-Maliki, the Shia prime minister, did well, particularly in the south. If confirmed—the final results are not expected for several weeks—Mr Maliki will be well placed to run for a second term in the general election due within a year. His success, though, did not reflect a trend towards voting along religious lines. Quite the opposite. The prime minister, who leads the Dawa Party, a Shia religious movement, seems to have benefited from his party's decision to join with others to form the State of Law Coalition, which campaigned, in a non-religious way, on themes of national unity, law and order. Mr Maliki thus managed to profit from an apparent shift to secularism.

The list of secular parties backed by Ayad Allawi also appears to have made gains, increasing the chances of Iraq's first post-invasion prime minister making a political comeback. And religious parties, such as the Supreme Iraqi Islamic Council, seem to have suffered corresponding setbacks, at least if anecdotal evidence is a guide. These parties were blamed for the culture of corruption that many Iraqis detect in the provincial councils.

In the northern province of Nineveh, Sunni Arabs seem to have taken seats from Kurdish parties. The paucity of their previous representation in Mosul, the provincial capital, has been blamed for much of the turmoil in the region over the past four years. Sunnis throughout the country have come to regret their decision to boycott past elections, in protest at the American occupation. Now they will at last secure fairer representation.

The main disappointment for the authorities was the number of people who turned out to vote. At 51%, or 7.5m of the eligible voters, this was lower than expected, and much lower than Mr Maliki's forecast of up to 80%. Confusion over registration will have depressed turnout in some places, as will a curfew that meant many old and disabled people had difficulty getting to the polls. A more worrying cause was the indubitable sense of disillusionment with the political parties that have come to power since the 2003 American-led invasion.

Whatever the final outcome, the election must be seen as legitimate to ensure a smooth transition of power. More than 14,400 candidates were vying for just 440 seats on the 14 councils up for election. Despite the general air of optimism about the voting, widespread mutterings about fraud could still precipitate a new cycle of violence. And that in turn could derail Mr Obama's plans to pull all American combat forces out of Iraq within 16 months.

Iran's 30-year-old republic

Defiant, and doubtful

Feb 5th 2009 | CAIRO
From The Economist print edition

Iran gives America the finger

FEBRUARY 1st marked the 30th anniversary of the return to Iran of the exiled Ayatollah Khomeini (see article), and his heirs have been celebrating the ensuing Islamic revolution. On February 2nd, to much fanfare, they launched an "indigenous" satellite, borne into space on a rocket of Iranian making, however much it may have owed to North Korean and other technology. Despite protestations that the achievement was entirely benign, with no menacing implications, it was greeted by the new administration in Washington with "great concern". No wonder: reversing his predecessors' stand-offishness, Barack Obama has indicated that he is ready for a direct dialogue with Iran. Launching a Safir-2 rocket looks very much like putting up a finger.

Iranians are no doubt proud of their scientific triumphs, despite the international sanctions that are unfairly, in their eyes, imposed on them, for their country's obdurate pursuit of nuclear technology. They largely agree about such things as the wickedness of American support for Israel and the justice of the Palestinian cause. But, if visitors to Iran are struck by anything, it is the dominant mood of weariness. Unlike the Soviet Union or China in the 1950s, Iran is not sealed off from the world. Via the internet, satellite dishes, travel and interaction with a 2m-strong diaspora, its people are painfully aware of the prosperous cosmopolitanism enjoyed elsewhere.

They cannot help wondering why, with its educated population and bountiful resources, including the world's second-largest reserves of both oil and natural gas, Iran struggles with high unemployment, low wages and surging inflation. Even if sanctions are partly to blame, rather than the all-too-evident managerial failings of President Mahmoud Ahmadinejad's government, they cannot help asking why the world should be so hostile. Yes, they believe that Iran is a great country, and should be treated as such. But does this require constant friction with other countries, or postponing all fun to the afterlife?

The urgency of these questions will grow as the next presidential election, in June, approaches. Despite the official bluster, the idea of a thaw with the West has lately been provoked by such melting events as visits by American sports teams and academics, and a directive from NATO letting its members seek supply routes through Iran for their forces in Afghanistan. This warmth has been accompanied by a crash in oil prices that is likely to slash government revenues in half, brutally shrinking Iran's margin for manoeuvre.

But Mr Ahmadinejad is not rolling over. Iran has pointedly failed to issue visas to an American women's badminton team this month. The president still enjoys strong backing from the supreme leader, Ayatollah Ali Khamenei. And his hardline allies, who have kept the reformist opposition in check since ousting it in 2005, may well now fix the June poll. In any event, they are hardly likely to allow the election of either a liberalising Gorbachev or a pragmatic Deng Xiaoping. But faced with the temptation of a more welcoming outside world, and the danger of economic paralysis at home, whoever it is that runs the Islamic republic may be obliged to opt for one of those models. After all, even the revolutionary imam himself, Ayatollah Khomeini, after eight years of war with Iraq, chose to "drink the cup of poison" and make peace with Iran's most loathed neighbour, Saddam Hussein.

Ethiopia

A row over human rights

Feb 5th 2009 | ADDIS ABABA
From The Economist print edition

The government says Human Rights Watch has got it wrong. Really?

INDEPENDENT voices in Ethiopia are finding it ever harder to be heard. Suffocated by an irascible government, the country's newspapers are now the least informative in east Africa. Journalists deemed critical of the prime minister, Meles Zenawi, are pilloried. And they are not alone.

Foreign aid people and diplomats say a law pushed through parliament last month will curtail the activities of local human-rights workers. The new law means that independent local outfits that get more than 10% of their income from abroad will be classified as foreign. Once designated as such, they will not be allowed to engage in anything to do with democracy, justice or human rights. Real foreigners are already banned from doing so. As few home-grown charities and non-governmental organisations can stand on their own feet in a country as poor as Ethiopia, the government will be able to control domestic dissent more tightly.

The task of raising human-rights issues now increasingly falls to foreigners. A particularly bitter tussle is under way over allegations of atrocities by Ethiopian soldiers in the country's south-eastern Ogaden region. This area abuts the border with turbulent Somalia and is populated mainly by ethnic Somalis traditionally hostile to the government in Addis Ababa, the capital.

Human Rights Watch, a pressure group, accuses Ethiopia of war crimes and crimes against humanity there. It says that Ethiopian troops burned down villages and killed, raped and tortured civilians in a counter-insurgency campaign against the separatist Ogaden National Liberation Front after its fighters had killed 74 Ethiopian and Chinese oil-exploration workers in 2007. Ethiopia's government was so incensed by the description of "systematic atrocities" in the Ogaden that it commissioned a report of its own that dismissed Human Rights Watch's allegations as hearsay and its methods as slapdash.

The government report found "no trace" of serious human-rights violations. People reported to have been killed or tortured were said to have been found alive and well. Villages marked down as torched were said to be unscathed. The sole admitted instance of torture was said to have resulted in a court-martial. According to the Ethiopian report, Human Rights Watch was one-sided, since it failed to document the guerrillas' thuggery. Perhaps unwittingly, said the Ethiopians, it had made itself a propaganda tool of the separatists.

The Ethiopian investigation did not, however, examine all of Human Rights Watch's accusations. Some executions listed by the group go unchallenged or are blamed unconvincingly on the guerrillas. The report skims over the Ogaden's humanitarian emergency, which Médecins Sans Frontières, a French-based charity, lists as one of the world's ten worst. The Ethiopian report flatly denies that the government blockaded separatist strongholds during a famine, thus starving civilians. The Ethiopians also lambast Human Rights Watch for not visiting the Ogaden, knowing that it was they who blocked the visit. They claim that the Ogaden has been open to anyone, yet most independent journalists have been banned from travelling there freely. Several aid organisations, including the International Committee of the Red Cross, have been kicked out. Aid workers there speak only anonymously, for fear of expulsion.

The government has a general election to win next year. A wave of arrests of political dissenters, including a prominent opposition leader, Birtukan Mideksa, suggests the government wants to keep all its opponents in check.

A simple way for it to win confirmation of its claim that Human Rights Watch's accusations are false would be to let independent journalists, both foreign and Ethiopian, visit the Ogaden and see for themselves.

Turmoil in Madagascar

I'm king of the...oops

Feb 5th 2009 | JOHANNESBURG
From The Economist print edition

The putsch that wasn't

AFP



The adoration of Rajoelina

IT'S so sad. After decades of economic mismanagement and periodic political crises, Madagascar, one of the world's poorest countries, looked set for sustained development and a return to the (relative) prosperity it once knew in the 1960s. Since President Marc Ravalomanana came to power in 2002, the former French colony in the Indian Ocean had enjoyed average economic growth of 5% a year, a booming tourist industry, rising foreign investment and stability. Now it has been plunged back into political turmoil with all that entails for its still fragile economy.

On January 26th long-simmering social and political tempers boiled over into an outbreak of rioting, looting and burning in Antananarivo, the country's capital, as tens of thousands took to the streets, egged on by their young firebrand mayor and opposition leader, Andry Rajoelina. They have been protesting against rising food prices and the perceived autocratic behaviour of their president, owner of Tiko, the island's biggest food conglomerate.

After a week of violence that left up to 100 dead, the 34-year-old Mr Rajoelina, a self-made business tycoon and former disc jockey, announced that he was now "in charge" of the country. Accusing Mr Ravalomanana of squandering public money and of threatening the country's young democracy, he demanded the president step down by February 7th or face impeachment by the Constitutional Court.

At one point, it looked as if Mr Rajoelina, who has been in politics for barely a year, might have overplayed his hand. Few heeded his call for renewed protests and strikes on February 2nd. But on the next day his supporters' ire was reignited when the government announced his summary dismissal for allegedly failing to carry out his duties as mayor. Hundreds of demonstrators again took to the streets in protest against what the mayor claims to be an "invalid" decision.

Ironically, the last time Madagascar saw protests like this was when Mr Ravalomanana, then (like Mr Rajoelina) the capital's mayor, called on the Malagasy people to back "democracy", after a disputed presidential election. On that occasion Mr Ravalomanana claimed (almost certainly rightly) to have won the contest. After six months of demonstrations, Mr Ravalomanana declared himself president and set up a new government.

Leaders at this week's African Union summit in Addis Ababa, the Ethiopian capital, ever anxious about threats to their own legitimacy, roundly condemned Mr Rajoelina's attempted putsch. Last year Guinea and Mauritania were both suspended from the 53-member organisation after successful coups. Addressing the meeting, Ban Ki-moon, the UN secretary-general, said he was "deeply concerned" by the violence in Madagascar, which is embarrassingly due to play host to the organisation's next summit, in

July.

Whatever happens now, Madagascar’s 20m people, most of whom survive on less than $1 a day, are bound to suffer. Foreign investors and tourists will both be deterred by the political instability and risk of violence. Standard and Poor’s, a credit-rating agency, has downgraded its outlook for the island from “stable” to “negative”. Poor Madagascar, indeed.

Kenya

Double trouble

Feb 5th 2009 | NAIROBI
From The Economist print edition

How corruption causes accidents

A YEAR on from a post-election squabble in which many innocents burned, Kenya last week experienced another kind of incineration. On January 28th an electrical fault turned a supermarket into an inferno in the centre of the capital, Nairobi; 28 shoppers were burned alive. Then, on January 31st, a petrol tanker overturned on a road near Molo in the Rift Valley, spilling thousands of litres of fuel. It ignited, killing 115 people who had gathered to scoop the precious liquid into jerrycans and scorching hundreds more. The death toll is expected to rise.

The two incidents have outraged Kenyans, exposing as they have the negligence of the country's police and officials, the incapacity of its emergency services and the inadequacy of its medical care. The government has sought to quell growing discontent by declaring a week of national mourning, but the questions remain. Why did it take an hour for decrepit fire engines to reach the blazing supermarket? And how was it that the building lacked the fire-safety features required by law? For many Kenyans, the answers lie in the way that regulations are often waived for bribes.

The calamity in Molo underlined the point. The tanker was overloaded and unsafe. The driver may have stopped in Molo to siphon off some of his employer's fuel and sell it to locals. There were familiar allegations of police misconduct. Instead of cordoning off the spill, survivors say police took bribes to allow people to go in with jerrycans. By some accounts, a vengeful youth who lacked the money to pay the fee tossed a lighted cigarette into the fuel.

Both the police and the minister for internal security angrily dismiss such stories, saying their officers were overwhelmed in the rush. They point out that several police died in the blaze. But such denials are wearing thin in a country strained by corruption and mismanagement. The parade of ministers passing through the country's only burns unit to visit the survivors has attracted more scorn than approval. Doctors say that ministers could immediately improve the situation by getting old vehicles off the road and enforcing speed limits. But it is doubtful whether the government is strong enough to stamp out the petty bribes that foster the carnage, especially when the culture of corruption includes so many higher up.




The euro area

A tricky balancing act

Feb 5th 2009
From The Economist print edition

Illustration by Peter Schrank



The euro area economy's vaunted strengths are starting to look like weaknesses

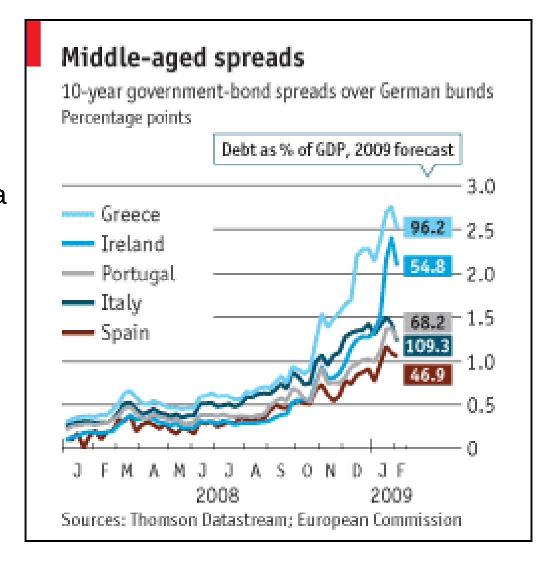
A YEAR ago, when the financial crisis was in its infancy, the euro area enjoyed a brief moment in the sun. Its peers in the rich world—including Britain, the largest European Union economy outside the euro—had enjoyed faster growth and lower unemployment but now looked vulnerable. Britain was everything a country should not be in a credit crunch: debt-ridden, reliant on foreign savings, chock-full of banks and estate agents, and short of firms that made tangible stuff. America ticked many of those boxes too. In contrast, Europe's past vices now seemed like virtues: rigidity recast as solidity, risk-aversion as prudence. When the crisis got worse in the autumn, the euro was a shelter for its members from the storms.

It is clear that America and Britain are indeed suffering badly. But so now is all of the rest of Europe. Figures due out on February 13th are expected to show that euro-area GDP shrank at an annualised rate of around 5% in the fourth quarter of 2008, worse even than the grim numbers from America, although not quite as bad as those for Britain. Business indicators have stabilised but this suggests only that the economy is likely to shrink at a similar rate in the current quarter, not that activity has stopped falling. The IMF forecasts that euro-area GDP will decline by 2% this year and barely recover in 2010.

More irksome still is that profligate America is able to borrow on better terms. Despite a sell-off (see article), the yield on a ten-year US Treasury bond is still half a percentage point lower than that on a German bund, which comes from the euro-area's most creditworthy country. Yields are lower partly because the Federal Reserve has driven America's short-term interest rates close to zero. It may yet buy up government bonds to push down long-term interest rates as well. The European Central Bank (ECB) is reluctant to go down that path, partly for fear that it might be seen to be bowing to political pressure. It is chary about more monetary stimulus of the normal kind, too: as *The Economist* went to press, it was expected to keep its benchmark interest rate at 2%.

For some governments, the ECB's foot-dragging is not the biggest worry. A greater concern is the extra reward that bond markets are demanding to hold their debt. Before the credit crunch, investors seemed scarcely less keen to lend to Italy than to Germany. Germany's ten-year bunds yielded as little as 0.2

percentage points less than the equivalents for Italy, despite a smaller public-debt burden. But that spread—like those of Ireland, Greece, Spain and Portugal—has widened (see chart).



Adding to the strains, Standard & Poor's, a credit-rating agency, has recently downgraded Spain, Portugal and Greece, and issued a warning that Ireland's public debt may lose its triple-A stamp. The odds of a sovereign-debt default have shortened, making other risks seem less improbable as well. Might the euro crack apart? The jump from possible default to break-up is a big one. And any country that had trouble financing itself within the euro would surely find life outside even less hospitable. Yet such talk shows just how troubled the euro countries now are.

In truth many of the euro area's supposed strengths were always more apparent than real. At the start of the financial crisis, there was much talk of the absence of "imbalances" in the euro area—unlike America, which had (and has) to borrow so much abroad. Yet the euro's external balance concealed a huge internal divide between places like Germany, with excess savings, and countries such as Spain and Greece, with huge current-account deficits. Such countries are most exposed in a credit drought, as they rely on foreign capital. So the hope had been that weaker demand in deficit countries would be offset by faster spending from hitherto prudent German firms and consumers.

Unfortunately, the instinct to save grows stronger in a downturn. The response of German firms to weaker export demand has been to cut investment plans. Consumers are warier too. So Germany's reliance on foreign demand has proved more of a drag even than other countries' reliance on foreign savings. The IMF forecasts that GDP will shrink more this year in Germany than in France, Italy or Spain.

The manufacturing bent of the big euro-area economies has also left them looking cumbersome rather than strong. Goods producers are hit hardest in downturns: consumers are more likely to defer spending on big-ticket items, such as cars and home appliances, than on the frequent small purchases that keep service industries ticking over. And firms are loth to lay out for plant and machinery—a German niche—when demand is so uncertain.

For all the pain endured by companies and the big drop in euro-area output, the region's unemployment is rising more slowly than in America or Britain. One argument is that Europe's tendency to hoard jobs in downturns may be a boon. Forced layoffs can feed a downward spiral of weaker spending and job losses. But recovery is also more likely to be delayed if weak firms in overstaffed industries are too slow to shed workers. So far, joblessness has risen a lot mainly in Spain and Ireland, because of their large layoffs in the construction industry. But there are signs that job losses are accelerating in France and Germany as well.

What default might look like

To some, the boast last autumn that the euro is a haven from financial storms was hubristic. The sharp rise in bond spreads for Greece, Italy, Ireland, Portugal and Spain shows that capital markets are now less forgiving of high public debt or rising budget deficits. It is likely, however, that borrowing costs would be even higher if any of these countries were outside the euro area, since an extra premium would then be required to compensate investors for currency risk. Italy's public debt is more than its annual GDP, yet it can still borrow for ten years at around 4.6% a year. It needs to raise €377 billion in capital markets this year, according to a report by Fitch, another rating agency, equivalent to some 23% of GDP, a huge number (though it has had to raise even more in the past).

One reason for rising credit spreads is the huge stock of bonds in the pipeline. Almost €2 trillion of public debt has to be raised by the euro area, Britain and Switzerland this year, equivalent to 17% of their combined GDP. Ireland alone needs about €47 billion to cover its yawning budget deficit, its bank bail-outs and to pay off maturing debts (see article). With so much supply to be absorbed by finicky markets, there is a worry that some bonds may go unsold. Yet that risk is easy to overstate, says Brian Coulton at Fitch, because there is little competition for funds from private borrowers. Even a failed bond auction need not be a disaster. Countries have liquid reserves to tide them over while they reprice bonds, says Mr Coulton.

Bond investors might still take fright if there is an unexpected rush of new borrowing—for a fresh bank bail-out, say. Were markets to lose patience, a country could for a while arm-twist local banks into buying

its debt, though that would curb other loans, hurting the economy. But it cannot ask the central bank to tide it over. The ECB is forbidden from buying debt directly from governments (though it can intervene in bond markets). Eventually the only option might be to default on maturing bonds. This need not imply exit from the euro; the political, budgetary, economic and legal costs of such a course are too high for it to be sensible.

More likely, a failure to pay off a loan on time would trigger a rescue package, perhaps led by the IMF but financed by richer EU states. It would be a messy business that would harm all euro members, says Daniel Gros of the Centre for European Policy Studies, a think-tank in Brussels. He believes the prospect of default is small. But since it could have such big costs, it might be safer to be prepared for it.

Food in France

Sandwich courses

Feb 5th 2009 | PARIS
From The Economist print edition

Faster food replaces the leisurely lunch

AS THE recession bites, a gastronomic indignity is nibbling its way through the land of fine dining: the humble sandwich. Last year the French munched their way through 1.3 billion sandwiches, 50m more than in 2007, according to GIRA Foodservice, a consultancy. The traditional sit-down lunch with the *plat du jour* at the local brasserie is, it seems, under threat. In 2008 bankruptcies of restaurants and cafés, affected also by the smoking ban, leapt by 26%. Is the global slump turning a nation of civilised lunchers into one of convenience snackers?

Even before the downturn, the French had acquired a taste for the sandwich. Between 2003 and 2008, the market jumped by 28% in volume. It is now worth some €4 billion ($5.1 billion) a year. This includes the triangles of bread favoured by the British and the French version made with a baguette. In recent years, boutique sandwich bars, offering such fillings as foie gras with onion confit, have spread across the business districts of Paris, attracting long lunchtime queues. Chains such as Paul, Lina’s (slogan: *le beautiful sandwich*) or Dailymonop’ have also taken root.

The young seem particularly keen, even (*quelle horreur*!) eating the things at their desks. The average 25-34-year-old consumes twice as many sandwiches every year as does a 45-54-year-old, says Raphael Berger, at the Research Centre for the Study and Observation of Living Conditions. Working women like *le sandwich*, says Jean Rossi at GIRA Foodservice. It “leaves them time to do other things, like going shopping, during their lunch hour too.”

Now, the downturn has produced another reason: price. The upmarket *sandwich gastronomique*, at €8 a shot, may be holding up, but the cheaper end looks likely to grow faster. In January a new sandwich chain called Goütu (a play on the word *goût*, or taste) opened in Paris, designed for the budget era. It offers sandwiches for as little as €1, calling them an “economical alternative”.

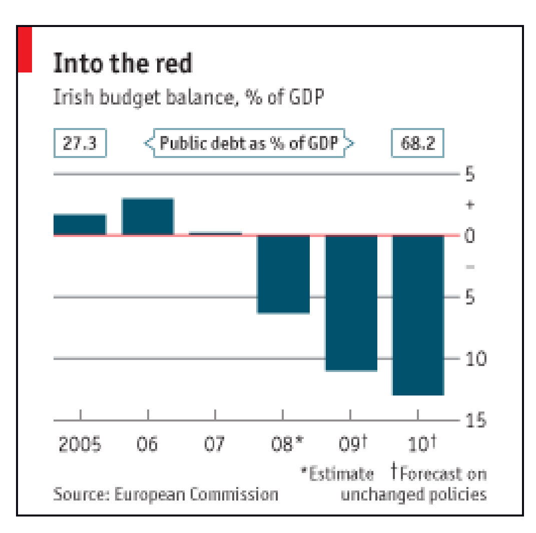
The French seem hooked. Next month, Paris will host the European Sandwich and Snack Show. Chefs from around the world will compete for the “Sandwich World Cup”. On six previous occasions, no French chef has ever won. Thanks to a fresh challenge from the lowly sandwich, the country’s gourmet reputation is now on the line.

The Irish economy

Reykjavik-on-Liffey

Feb 5th 2009 | DUBLIN
From The Economist print edition

The Irish government struggles with the effects of a deep recession



THE difference between Ireland and Iceland, so the current joke goes, is one letter and six months. A Dublin economist responds that the real difference lies in a four-letter word: euro. Ireland is in, and Iceland is not. A former European commissioner from Ireland, Peter Sutherland, thinks that Europe's single currency has kept Ireland afloat. Even so, GDP is expected to contract by 5% and the unemployment rate to rise to over 9% this year. And Ireland is bracing itself for a credit downgrade on its sovereign debt.

Much will depend on how the rating agencies judge the latest efforts by the prime minister, Brian Cowen, to stabilise the public finances. On February 3rd he made a poor start, before recovering. After weeks of talks, he failed to win trade union support for his budget cuts. Yet hours later he imposed the measures the unions had rejected, including a pension levy on public-service workers. His unilateral action signalled the end of two decades of social partnership, based on a consensus approach to wage bargaining between government, employers and unions.

Mr Cowen's cuts are the first steps in a five-year austerity programme meant to close a huge budget deficit. But they come at a hard time. The economy has been hit by the global credit crunch, a burst property bubble and collapsing tax revenues. This year's estimated budget deficit will be some 10% of GDP, even after the latest cuts. The government hopes to restore balance by 2013, but that will take spending cuts and tax increases worth €16 billion (equivalent to 8% of GDP).

The rapid deterioration in the public finances has unnerved bond markets and raised Ireland's borrowing costs. In recent weeks Irish bond spreads over German bonds have widened by over two percentage points. Yet Mr Cowen's political problem is that he is ill-placed to sell acceptance of five years of austerity. His government has struggled with its banking crisis. Morale has been dented by a succession of economic shocks. Last month Waterford Wedgwood, a maker of luxury glassware and china, went into receivership; and Dell, a computer maker, announced it was closing its manufacturing plant in Limerick, with the loss of 1,900 jobs, and moving to Poland.

The government's public standing could hardly be lower. In a recent poll three out of four respondents said its handling of the economy had been poor. Fianna Fail, which leads the coalition and has been in power since 1997, is trailing in the polls. Mr Cowen's only consolation is a favourable shift in views of the European Union's Lisbon treaty. There is expected to be a second referendum on this in the autumn, and recent polls show a two-to-one majority in favour. Ireland's euro membership during the recession may make all the difference at the ballot box.

Turkey's prime minister

Temper tantrums

Feb 5th 2009 | ANKARA
From The Economist print edition

A dramatic Davos walkout raises new questions about Recep Tayyip Erdogan

WAS it premeditated? Or did Turkey's prime minister, Recep Tayyip Erdogan, lose control? Mr Erdogan's walkout from a debate with Israel's president, Shimon Peres, in Davos has made him the most talked about Turkish leader since Kemal Ataturk. His audience of financiers and policy wonks was stunned. But Muslims worldwide cheered as Mr Erdogan scolded Mr Peres over Israel's war in Gaza. "When it comes to killing, you know very well how to kill. I know well how you hit and kill children on beaches," thundered a crimson-faced Mr Erdogan.

The incident has led to new debate over Turkey's strategic alliance with Israel, whether an increasingly erratic Mr Erdogan is fit to lead Turkey at all and, if so, in what direction: east or west? There is no question of Turkey walking away from NATO or the European Union, or scrapping military ties with Israel and America. Mr Erdogan's critics say his outburst was a ploy to please voters. If so, it worked: his approval ratings have shot up. Polls suggest that 80% of Turks support Mr Erdogan's actions. His mildly Islamist Justice and Development party will reap dividends in municipal elections on March 29th.

Mr Erdogan's defiance has also helped to assuage his people's long-running feelings of humiliation and inferiority, which date back as far as the Ottoman defeat in the first world war. Many insist that Mr Erdogan's reaction was spontaneous and utterly sincere. Turkey has assumed "moral leadership" based on Western values, opined Cengiz Candar, a liberal commentator. Mindful of the public mood, Turkey's secular opposition leader, Deniz Baykal, grudgingly declared that his rival had done the right thing.

Not everybody agrees, however. Mr Erdogan's behaviour makes it less likely that Turkey can successfully mediate between Israel and Syria. His call to Barack Obama to "redefine" what terrorist means has been seen as an appeal to remove the label from Hamas. Although European and American reaction has been muted, in private officials are unhappy. "What [the Davos spat] does leave in Europe is the feeling that Mr Erdogan is unpredictable," says a European diplomat. Mr Obama is highly unlikely now to pay Turkey an early visit.

Mr Erdogan's temper tantrums are not new. But they used to be reserved for his critics at home. The Davos affair, says another foreign diplomat, is further evidence of "Mr Erdogan's conviction that the West needs Turkey more than Turkey needs it." It is of a piece with Mr Erdogan's threat to back out of the much-touted Nabucco pipeline to carry gas from the Caspian Sea to Europe via Turkey. In Brussels recently Mr Erdogan said that, if there were no progress on the energy chapter of Turkey's EU accession talks then "we would of course review our position". Meanwhile, Turkey sided with Saudi Arabia and the Vatican in opposing a UN statement suggested by the EU to call for the global decriminalisation of homosexuality.

Mr Erdogan's supporters argue that EU foot-dragging on Turkey's membership bid explains why Turkey is now seeking new friends in the Middle East and beyond. Its growing regional clout is another reason why the EU should embrace Turkey. But the reverse is also true. It is because it is the sole Muslim country that is at once secular, democratic and allied with the West that Turkey commands such respect in the rest of the world. Growing numbers of Arab investors have flocked to Turkey, "because we see it as part of Europe, not the Middle East," says an Arab banker in Istanbul.

To retain its allure, Turkey will need to swallow its pride and make further concessions on Cyprus. The EU may suspend membership talks altogether unless Turkey meets a December 2009 deadline to open its ports to Greek-Cypriots. The hope is that Egemen Bagis, who was chosen as Turkey's official EU negotiator in January, will remind Mr Erdogan that, at least in these talks, it is Turkey that is the supplicant not the other way round.

Spain's rail ambitions

Ave Madrid

Feb 5th 2009 | BARCELONA
From The Economist print edition

Spain plans the most extensive high-speed rail network in Europe

EARLY morning at Barcelona's railway station and the platform crowd looks smarter than it would have done a year ago. But these are not ordinary weekday commuters. They are besuited businessmen heading for Madrid, almost 500km (310 miles) away. A sleek new high-speed AVE train will whisk them to the capital at speeds of up to 300kmph in plenty of time for their morning meetings.

The new passengers reflect a revolution in Spanish travel. Domestic airlines have lost a fifth of their passengers in the space of a year. And long-distance trains have gained almost a third.

This shift is the consequence of an ambitious programme for high-speed rail. The streamlined AVE trains, with their sleek corridors, work tables and spectacular views, are stealing the show. Those used to the tedious taxi rides, security checks and crowded shuttle flights traditionally endured by Spanish businessmen will not be surprised. The opening of the Barcelona-Madrid line a year ago marked the beginning of the end of airlines' dominance. In its first ten months it carried 2m passengers; in 2008 its share of the total market rose from 28% to 38%. Josep Valls, of the ESADE business school, predicts that trains will carry most long-distance travellers within two years.

Spain's high-speed network is still in its infancy. Another 9,000km of lines are planned over the next decade. The aim is to create Europe's most extensive high-speed network, with 90% of Spaniards living within 50km of a station.

Shifting people on to high-speed trains has needed both careful planning and political consensus. When José Luis Rodríguez Zapatero's Socialist government proudly opens new stations, it is often reaping rewards sown by previous administrations. But Mr Zapatero's commitment cannot be faulted. New lines are being built in every corner of the country. Under a recent agreement the network will even be extended into Portugal.

Critics still complain that politics has loomed too large. The first AVE line did not connect Madrid to busy Barcelona but to sleepy Seville, the home town of the then prime minister, Felipe González. Even now, whereas small provincial cities like Valladolid and Segovia are connected to a new line, it will still take several years to link up with France's network.

Not everybody loves the train. In Barcelona people fret that its vibrations may topple the Sagrada Familia cathedral. In the Basque Country ETA terrorists have hijacked a campaign against the AVE begun by environmentalists, killing a local contractor who was working on it. Yet the train wins most of the environmental argument. Carbon emissions per passenger are one-sixth as big as for air travellers. High-speed lines also free up existing railways for cargo, keeping lorries off roads.

Prices vary and can be hard to compare. Budget airlines tend still to be the cheapest on the Madrid-Barcelona route. Fernando Conte, chairman of Iberia, Spain's biggest airline, also insists that "point to point we are quicker." Yet that assumes aircraft take off on time and there are no traffic jams. Savings on taxi fares plus a 99% punctuality rate are usually enough to push people on to the train. Tellingly enough, Iberia is planning to cut domestic flights by 7% this year.

So the train is taking the strain in Spain. For comfort and countryside views, there is no beating it.




Amsterdam's troubled metro

A big dig

Feb 5th 2009 | AMSTERDAM
From The Economist print edition

Undermining a city and overrunning on costs

DRILLING tunnels beneath the wooden pillars that support one of Europe's oldest cities sounds mad. Yet this is what Amsterdam decided to do in 2002, when it chose to build a new metro line. The line starts in the north and heads south under the Ij river, the central station, Dam Square and Rokin. For six years, the area south of the station has been a huge construction site. Deadlines have stretched; the budget has doubled, from €1 billion ($1.3 billion) to €2 billion.

The metro is a sore point in local politics. In the 1970s planners tore down one of Amsterdam's oldest quarters in the east to build a line between the central station and the suburb of Bijlmer. Local residents fought fiercely to save parts of their old city. Atop the metro today is one of the city's worst eyesores: a four-lane highway known locally as Stalin Alley.

That trauma kept the city's metro ambitions in check for 20 years. Yet the number of commuters has risen to 1.3m, almost twice the city's population. The centre is chronically clogged with trams, cyclists, tourists and taxi-drivers. "We have to move commuters under the ground," says Tjeerd Herrema, the alderman responsible. "There is simply no space for them on the streets any more."

Drilling technology has improved, allowing tunnels to be dug without breaking the surface. Only the stations were built at first. This year, a huge circular bore is to be lowered into a layer of sand deep beneath the city, where it will drill a tunnel to link them. The hope was that this would not disturb the thousands of wooden pillars on which the city rests. Along the route lie such landmarks as the 1903 stock exchange, several high-end shops, the royal palace on the Dam and houses from the 17th century. A system of sensors and mirrors would signal the tiniest sinking—in theory.

Yet last summer several houses along the route suddenly sank a few centimetres without warning. Their occupants, alerted by the cracking, escaped through windows. All underground work was halted. A special commission said construction work was substandard and suggested that it should proceed only if the ground were frozen, which would increase costs. The ombudsman criticised the city for its poor supervision.

Herman Philipse, a philosopher, has appealed to civic leaders to "summon the courage" to halt the metro and leave the city centre to cyclists. Yet Mr Herrema and his colleagues are adamant. Amsterdam will modernise unless it becomes clear that the metro is technically impossible, which he doubts. "The moment the metro is finished, people will use it and love it," Mr Herrema predicts. At least those whose houses still stand.




Charlemagne

Single-market blues

Feb 5th 2009
From The Economist print edition

Recession is bringing fresh threats to Europe's single market

Illustration by Peter Schrank



IN FRANCE railway crossings are adorned with a small lesson for a life of gnomic brevity. "One train can conceal another," is the message printed on warning signs. It is a motto that supporters of free trade should remember as they scan the horizon for threats to the European Union's greatest achievement: the borderless single market. Those watching out for protectionism have plenty to alarm them, right before their eyes. But the biggest threats to the single market are those hidden from view.

Start with the visibly alarming. France's President Nicolas Sarkozy, an express train in human form, has hinted that billions of euros in aid for the French car industry should be made conditional on keeping production in France (and perhaps on buying French-made components, unnamed aides have briefed). There has been no less furious tooting and whistling from politicians in such places as Spain, Britain and Greece as they nag bailed-out bankers to lend first to domestic businesses and households. The Greeks publicly "advised" banks to be "more prudent" about transferring bail-out funds to Balkan subsidiaries. A nasty industrial dispute, sparked when Italian and Portuguese workers were posted to an English oil refinery, led one British minister to urge changes to EU law to stop foreigners undercutting Brits.

Yet so far, say European Commission officials, most such announcements amount to "virtual" protectionism. Politicians thunder about shielding domestic jobs, but in the detail of their plans, they have avoided direct challenges to EU competition and state-aid rules. Linking public funds to a strict "buy French" policy for car parts, for example, would clearly be illegal. It would probably be equally illegal to link aid to a nationwide ban on moving production elsewhere in Europe (though regions can link funding to promises to keep specific factories open).

European leaders have not forgotten the lessons of the 1930s, and accept that measures to harm neighbours would trigger a downward spiral of protectionism. Most EU governments are sincerely horrified by the "Buy American" provisions added to the Obama administration's stimulus package by Congress. Many governments are frankly short of money, and are wary of subsidy races against each other. All the main political parties in Britain have condemned the current wildcat strikes against foreign labour, and defended the benefits of the free movement of people, goods, capital and services inside the EU.

Yet dangers lurk, even so. This credit crunch will test all sorts of EU disciplines. Last month the commission revived EU export subsidies for dairy products for the first time since 2007, amid falling prices. After a similar plunge in olive-oil prices, Italy wants the stuff added to an EU list of foods that can be bought with public money and given to the poor. Greece is now trying to buy off its protesting farmers with a €500m ($650m) aid package for olives and other crops. The Greek plan could yet fall foul of EU

rules: it is presented as an insurance scheme paying out for weather-damaged crops and rising input costs, but the amount is too big.

There are other warning signs that governments are thinking selfishly. There is a reason why every stimulus plan contains infrastructure projects, says one senior official: it minimises the risk of public money leaking to other countries. In contrast, if governments try to boost consumption (say with tax cuts) lots of the extra cash might go on imported goodies. Public works are also pleasingly visible to voters. A list of 1,000 stimulus projects to start this year in France is nothing if not splendidly French. Some 45 cathedrals are to be restored and also several castles, alongside the usual high-speed rail lines and roads. The Spanish government is so proud of a public-works blitz of 32,000 projects that it wants to mark them with red-and-yellow metal signs four metres wide and three metres high.

Yet a cornerstone of the single market is the idea that big public works should be put out to tender across the EU. The philosophy is clear enough. Contests keep local firms competitive and ensure value for money for taxpayers. Now that argument is under strain. Commission officials report political pressure to raise the threshold at which EU-wide tendering must occur, currently €5.15m for public-works projects. France wants the procurement rules tweaked to favour smaller firms.

Compete or protect?

Enforcing EU rules is going to become ever more painful. The Spanish prime minister, José Luis Rodríguez Zapatero, has promised that his public-works programme will create 300,000 new jobs, with hiring policies favouring the unemployed. That is allowed. But under EU rules, the jobs cannot be reserved for unemployed locals or Spaniards.

The same goes for British politicians when they talk of stopping foreign posted workers “undercutting” British rivals. The truth is that the single market was always intended to bring out the competitive advantages of every corner of the EU. That includes allowing workers from, say, Poland, to offset lower productivity with lower wage costs, as long as minimum European standards were met. Ever since the EU began enlarging to take in poorer members, west European trade unions have been worried about keeping their high levels of social protection. Recent British protests are no surprise: commission officials had long expected action in Britain against foreign workers brought in under the posted workers’ directive, a trade union bugbear.

The single market is firmly in the left’s sights. The European Trade Union Confederation, an umbrella body, has drafted a new “social protocol” it wants to add to the next EU treaty, saying the single market “is not an end in itself”, but must be balanced by “social progress”. That would split the EU between old and new members, and play into the hands of economic nationalists. A great deal is at stake as this crisis deepens. Without a lot of vigilance, the single market could be derailed.

Discontents, wintry and otherwise

Feb 5th 2009 | NORTH KILLINGHOLME, LINCOLNSHIRE
From The Economist print edition

AP



Worries about Britain's open labour market are growing

THE Lindsey oil refinery is a 500-acre leviathan of soaring towers and contorted pipes that looks as if it has been scooped out of America's rustbelt and dropped on an otherwise bucolic Lincolnshire landscape. Outside the plant from January 28th was a less prepossessing sight. Hundreds of striking workers huddled in the cold, a patchwork of wool hats and thick gloves intermittently dusted with snow, brandishing placards protesting the presence of foreign workers hired to expand the refinery.

The spectacle has been repeated elsewhere. Sympathy strikes (technically illegal since the 1984 miners' strike) sprang up quickly, and by February 4th, 22 other sites had been affected, with an estimated 6,000 workers walking out (see map below). That seems mild compared with some titanic chapters in British labour relations. But there is more to this walkout than the usual dispute over pay and conditions. The strikes give voice to a combustible mixture of emotions: fear of job losses, concern about foreign labour (and immigration generally), unease over a remote yet powerful European Union and disillusionment with a Labour Party that seems unsympathetic and uninterested to many of its traditional supporters.

The proximate cause is tortuous. Total, the French oil firm that owns the refinery, hired Jacobs, a Californian engineering outfit, to extend the plant. Following tenders from British and foreign firms, Jacobs subcontracted the work to IREM, an Italian company, which has shipped roughly a hundred of its permanent (Italian and Portuguese) staff to Britain to carry out the work. Hundreds more are still to come. It is not known why the jobs were given only to foreigners, as the contract is secret: IREM has worked with this team and is thought to believe its staff especially skilled. The strikers, evangelical about British workmanship, say it is because the newcomers are undercutting local wages and conditions—a claim both IREM and Total deny.

Legally, at least, the protesters seem to be on shaky ground. EU citizens are generally allowed to work in any member state. IREM's workers are in Britain under a specific chunk of EU law, however—the "posted workers" directive, which is designed to let firms use their own staff on temporary projects elsewhere in Europe without distorting competition. Even if IREM's workers were undercutting their British rivals (officials from Unite, Britain's biggest union, are shy of making the accusation directly), it would not necessarily be illegal. Foreign workers have the same rights as locals. But, as Vince Toman, a labour-law expert at Lewis Silkin, points out, workers in Britain have few legal protections compared with many counterparts on the continent, where "fair wage" rules often specify rates for particular jobs. In Britain firms are obliged to pay only the national minimum wage (£5.73, or $8.30, an hour), far less than rates specified in a national voluntary agreement that governs much of the work within Britain's construction

industry.

Opposition Conservatives accuse Gordon Brown of having stoked the embers of nativism with a pledge of "British jobs for British workers" in 2007. The theme—uncomfortably redolent of Britain's far-right fringe—was recently echoed by his home secretary, Jacqui Smith. Now the government has come to its senses. The prime minister has talked up the benefits of open labour markets. Lord Mandelson, the European-minded business secretary, has given warning that a protectionist lurch would turn "recession into depression". In any event, many more Britons are "posted" abroad in the EU (some, it seems, working for IREM) than Europeans are in Britain.

There are political temptations to be more placatory: the white working class, the bedrock of Labour's electoral coalition, has grown estranged from the party over the past decade. Yet Mr Brown knows better than most that Labour's 18-year exile from power after 1979 owed much to its failure to get tough with industrial militants. Helpfully, the party's backbenchers are not proving particularly querulous. Many would like a kindlier tone, but, perhaps due to an aroma of xenophobia that some detect on the picket-line, they crave a speedy resolution even more.

In the short run, they will get their wish. After being assured by Total of new jobs for around 100 British workers, strikers voted on February 5th to return to work four days later. But the wildcat strikes in sympathy suggest submerged, wider fears that a job-killing recession is now bringing into sharper focus. Just as the Total dispute died down, another flared up. On February 5th construction workers gathered to demonstrate outside the London offices of Alstom, a French firm, for a chance to participate in equipping the new Staythorpe power station in Nottinghamshire. The work has been awarded to foreign subcontractors and their teams.



Energy is one of the few sectors set for a construction boom in Britain, and is thus one arena where more of such grievances are likely to be fought out (the 2012 Olympics is another). Staythorpe is among several planned new gas-fired power stations. Coal and nuclear plants are also on the drawing board, as is storage for natural gas, liquid-gas import terminals, new pipelines and expanding the electricity grid to accommodate more renewable energy.

British companies could perform some of the work, but foreign firms may be needed to carry out more highly skilled tasks. Unions fret that foreign contractors will freeze out local workers, and the fact that many of the firms commissioning the work are now foreign-owned may aggravate their worries. But Britain's hollowed-out manufacturing sector lacks the capacity to produce much of the specialist machinery that such projects require, says David Lindley, a fellow of the Royal Academy of Engineering and once a director of Taylor Woodrow, a construction firm.

Though case-by-case solutions may emerge, the underlying tension between openness and protectionism will endure. That the Tories and the Liberal Democrats have had little to say beyond lampooning Mr Brown's foolish slogan underlines a shared view that Britain must back open markets while giving its workers skills superior to their competitors'. But challenges to this consensus may come from the protectionist far-left and the nationalist far-right. The cosy prosperity of the past decade was barren ground for political extremes; the coming years might not be.

Torture and the law

That curious relationship

Feb 5th 2009
From The Economist print edition

Evidence of alleged torture is suppressed, after alleged American threats

“IT IS often said the United States and Great Britain have long enjoyed a special relationship,” beamed Hillary Clinton, as Britain’s foreign secretary, David Miliband, visited the new secretary of state in Washington, DC, on February 3rd. The next day Britain’s High Court handed down a ruling that shed less flattering light on it. Lord Justice Thomas and Mr Justice Lloyd Jones said they could not make public evidence relating to the alleged torture of a British resident at American hands, for fear of a grave “threat” made by America last year if the evidence were published.

The British resident is Binyam Mohamed, an Ethiopian citizen who lived in Britain for seven years until he was arrested in Pakistan in 2002 and held incommunicado, initially in Pakistan and then in Morocco and Afghanistan, for two years. During that time he was interrogated and, he claims, tortured by American agents and those acting on their behalf, using questions supplied by a willing MI5. In September 2004 he was taken to Guantánamo Bay.

Mr Mohamed wanted the court to make public a summary (seen by his lawyers) of his treatment in custody. Seven paragraphs long, it is based on evidence from British intelligence officers briefed by American officials. The judges say it is “highly material to [Mr Mohamed’s] allegation that he had been subjected to torture or cruel, inhuman or degrading treatment”, but contains nothing that would reveal identities, facilities or other intelligence secrets.

Nonetheless, the judges ruled, they could not publish it, owing to evidence from Mr Miliband that America would retaliate by withholding vital intelligence in future, thereby placing Britain at risk. With majestic disdain, they expressed surprise “that a democracy governed by the rule of law would expect a court in another democracy to suppress…evidence [that] was relevant to allegations of torture…” Mr Miliband’s lawyers confirmed that under the Obama administration the position had not changed.

After the judges ruled, Mr Miliband denied that America had issued a direct threat. But the case is reminiscent of Britain’s decision in 2007 not to pursue investigations into alleged bribery of Saudi officials by BAE Systems, a defence contractor, for fear that Saudi Arabia would stop sharing intelligence. Most in Britain will have hoped that the relationship with America was different.

Monetary policy

Breaking the rule book

Feb 5th 2009
From The Economist print edition

Britain's central bank makes a foray into the unknown

THE Bank of England cut interest rates yet again on February 5th, from 1.5% to 1%, a new historic low. That much was predictable, that much conventional. What lies ahead is novel and unorthodox.

The decision by the monetary-policy committee (MPC) to reduce rates for the fifth consecutive month came as little surprise, but it had been opposed. Before the MPC's meeting the Building Societies Association, representing mutually owned mortgage lenders, pleaded for a stay on interest rates, arguing that the reductions had already had a "severe impact on savers". But the MPC thinks, for its part, that the overall effect of rate cuts on the economy is positive, not least because they benefit firms as well as indebted households.

Even so, the help that further cuts can give a flagging economy is probably diminishing, partly because some borrowers on tracker mortgage loans linked by a set margin to the Bank of England's base rate are subject to limits beyond which lenders will not reduce the interest rate they charge. That is one reason why the central bank is marching into unconventional territory in order to boost the economy.

Taking a cue from techniques already being deployed in America by the Federal Reserve, the Bank of England will start purchasing corporate debt such as bonds and commercial paper. The initiative formed part of the government's second package of measures recently unveiled by Alistair Darling, the chancellor of the exchequer, to try to prevent the banking snarl-up from throttling the economy.

The goal is to drive down the spread between the cost of corporate and of government borrowing. Until the credit crisis these were around a percentage point for corporate bonds, but they have since widened to a supersized gap of over five percentage points (see chart).

The spread of fear
Bond yields, %

Merrill Lynch corporate index
Government 10-year
10 9 8 7 6 5 4 3
2006 07 08 09

Source: Thomson Datastream

Some of the gap can be attributed to fears that companies will go bust, a risk that has risen sharply with recession. But the Bank of England thinks a big chunk of it is compensation for the fact that markets are not trading normally. This makes them illiquid: investors cannot be sure that they can sell holdings as and when they want to. The hope is that the arrival of a determined buyer, in the shape of the central bank, will restore more normal trading and thus narrow the part of the spreads caused by illiquidity.

If the policy works, it will allow firms to raise finance on better terms from investors. This in turn will ease the pressure on banks, which can concentrate on lending to smaller firms unable to access the markets by issuing bonds. More generally, a reduction in yields should boost financial confidence by dispelling fears that the jumbo spreads reflect only jumbo default risks.

For the time being the initiative will not entail the more controversial policy of "quantitative easing", which is already being pursued in America. This is because the corporate-debt purchases, worth up to £50 billion, will be financed by short-term Treasury bills issued by the government, whereas with quantitative easing the central bank would pay for them by creating money. That step may yet lie ahead: when Mr Darling announced the new facility he said it could be used for that purpose.

The government will nonetheless tread cautiously. Quantitative easing is a tricky policy to sell for it amounts to printing money, evoking images of wheelbarrows of notes in Weimar Germany. In practice the central bank creates the money by crediting the accounts that banks hold with it, thus raising their reserves. That increases the monetary base (cash and commercial-bank reserves) but not necessarily the

broad-money supply (cash and deposits). Banks may choose to cling on to their reserves, thus undermining the effectiveness of the policy—as happened when Japan used quantitative easing earlier this decade to fight deflation.

Quantitative easing may yet come to Britain. For the time being, however, the Bank of England will stick to orthodox techniques to lower interest rates until they approach the limit of zero.

Snowbound Britain

White-out

Feb 5th 2009
From The Economist print edition

Struggles and revels in the drifts

AFP



CONSIDERING that gusts of leaves have been known to overwhelm Britain's infrastructure, it is not surprising that the heaviest snowfalls since 1991 paralysed much of the country this week. London and the south-east were blanketed first: all of the capital's buses stayed in their depots on February 2nd; hospitals cancelled appointments; passengers were snowed into Heathrow; the post did not get through. Across the country, thousands of schools closed. Several people died in snow-related accidents.

After the deluge, the recriminations began, along with the usual spurious guesstimates of the supposed multi-billion-pound losses to the economy. Newspapers bemoaned a lack of grit, both on the roads and in the population. Even the blitz didn't stop London's buses, some lamented; how would today's Britons have fared in winters of yore, when the Thames froze? Ken Livingstone, the capital's ex-mayor, tried to implicate Boris Johnson, his successor. Mr Johnson explained that London had experienced the right kind of snow, but in "the wrong quantity". All sides blamed strangulating health-and-safety regulations.

It is true that some local councils should have done better, given the advance warning they had from the weathermen. But, as pundits pointed out, serious snow has in recent decades fallen on London so rarely that investment in the sort of kit that might have kept the city moving—snowploughs, bulldozing attachments for the fronts of trains and special tyres for buses, of the kind deployed in cities such as Moscow or Stockholm—would not make sense.

But costs and culpability did not seem to be the main concern of most Londoners, especially those too young to remember the last serious flurry. Sleds were improvised from the lids of recycling boxes. Parents fought snowball wars with children (a fifth of people stayed off work, reckoned the spurious guesstimators): happy, perhaps, to be out of the office for reasons that didn't involve their firms going into administration; grateful, maybe, for some puerile fun in gloomily adult times. Ugly things became beautiful; beautiful things looked miraculous. For once, London resembled its image in soppy films made by Richard Curtis.

The snow revealed as well as concealed. In London it uncovered an unwonted camaraderie among strangers, a secret yen for friendliness. At least, until the snow hardened into ice, the whiteness turned to sludge and everyone started to moan again.

Jaguar Land Rover

Cash-hungry

Feb 5th 2009 | GAYDON, WARWICKSHIRE
From The Economist print edition

Illustration by David Simonds



Will anyone feed this eager customer?

“I’M NOT a banker,” says David Smith, chief executive of Jaguar Land Rover (JLR). Yet arguably it is bankerly skills that are most needed to get JLR, Britain’s biggest indigenous carmaker, through the next month or so. Otherwise, the builder of swift Jaguars and go-anywhere four-by-fours could be forced to slash investments and orders from suppliers, driving British car manufacturing to a lingering death. Or so say the pessimists.

Last June Ford (which had bought Jaguar in 1990, Land Rover in 2000 and then combined them) sold JLR to Tata, an Indian group. In its Ford days JLR relied on Ford Credit to finance operations and sales, and did not need direct relationships with banks. Now it does.

But no bank today wants to take on a big new customer whose outlook is so uncertain. Since August JLR has been losing money, and Tata has poured in a reported £400m in debt and equity. Before then the firm had been on a roll, with Land Rover sales breaking records and Jaguars doing well after years in the doldrums. The credit crunch stopped all that. Mr Smith believes that in six months some of the world’s 12m or so dollar millionaires will start to buy premium cars again—not as many as before, but enough to put JLR back in profit.

Even if they believed him, bankers are now obsessively risk-averse. “This is equity risk, not credit risk,” says one: if equity investors were to put money into JLR today, they would want a 40-50% return. That misses the point, says Mr Smith—all JLR needs is normal commercial lines of credit. If banks won’t do that alone, then they might with a government guarantee.

JLR heads the queue for government-help to carmakers, though Tata today is meeting its immediate needs. It has applied for £400m from the European Investment Bank, and hopes some of that, and up to £500m of commercial-bank lending, will be guaranteed by the British government. But noises from that source have been confusing. A promised £2.3 billion in loan guarantees for the car industry unveiled by the government on January 27th seems vague and inaccessible, the firm says. JLR has discussed securitising assets, such as its inventory of cars, with potential lenders, to no avail. It might be able to use Bank of England funding when the central bank begins to buy company debt.

Is JLR worth saving? In the West Midlands there is no doubt: 75,000 jobs in the region depend on the firm. Some of its suppliers are already in trouble. When MG Rover, another carmaker, closed down in 2005, 90% of its employees found work. But they found less-skilled jobs, and in less-stressed times. David Bailey, of Birmingham University, calculates that if the state risked £1 billion in guarantees it would secure JLR’s annual £1.3 billion of tax and insurance payments and avoid £2 billion in payouts triggered by its closure.

Then there is the emotional factor. Jaguar and Land Rover are icons. The original Land Rover Defender, which turned 60 last year, has long symbolised British pluck in the far reaches of empire. It has given birth to an even better off-road vehicle, the Discovery, and a luxury toy, the Range Rover. Jaguar, for its part, seems to have rediscovered its old flair, judging by last month's sales in America—up 17.6% on January 2008, while other premium cars plunged. At the end of the year, two new models, the Jaguar XJ and the Land Rover LRX, are likely to wow buyers, Mr Smith says hopefully. Jaguars now outshine "increasingly bland German products", he maintains.

At the same time, all JLR's cars are being transformed within, through the use of lighter components, fuel-saving technology and electrical-drive combinations. The target is to make them 25% cleaner by 2015. To do this, JLR intends to spend £800m on research and development over the next two years. Not enough, says Julia King, vice chancellor of Aston, Birmingham's other university: to deserve government backing the company should lead a much faster green revolution.

Whatever JLR does, the government must act quickly, concluded a car-industry gathering in Birmingham on February 3rd, not to help ailing businesses "but to show faith in successful ones". Mr Smith may not be a banker but he needs to talk the right language to get that support.

Price-comparison websites

Caveat surfer

Feb 5th 2009
From The Economist print edition

Consumers are sheltering online. But comparison sites are suffering too

THERE are few more boring ways to spend a Saturday than phoning around for quotes on household utilities and financial services. But as people look to trim their budgets, the internet is making the process less painful: price-comparison sites, which scour the web, can return scores of options in a few seconds. Thanks to an advertising blitz in the past two years, they have grabbed a giant stake in some markets: up to 40% of car insurance in Britain is now sold through comparison sites, according to Datamonitor, a research firm. Moneysupermarket.com, the biggest of the hundred or so players, turned over £99m in the first half of 2008.

Nowhere in the world are such sites so influential. One reason is that insurance, their biggest market, is commonly sold directly by insurers in Britain; in most of Europe brokers do the lion's share. Utilities, too, are unusually easy to change: each year 18% of Britons switch their electricity supplier, against 3% of Germans. And online banking is well established, so buying financial services via the web comes naturally. The experiment is to be repeated abroad: Moneysupermarket has just started up in Germany and Confused.com, a rival, plans to open in Europe this year.

Not everyone is delighted about the rise of these sites. Their revenues come from commission on products they recommend, and for some products, notably insurance, they refuse to list providers who fail to cough up. Some particularly resent the way sites style themselves consumer champions, rather than paid introducers (a notion that newspapers seldom question, since most use the comparison companies to power parts of their own websites). And regulation is piecemeal: whereas Consumer Focus, an energy watchdog, endorses only sites that give quotes for all energy companies (including those that do not pay commission), there is no equivalent code for insurance listings.

A backlash is under way. Some insurers have refused to pay the commission and opted out; one, Direct Line, portrays its absence from the sites as a virtue, claiming that it has "taken out the middleman". That is doubtful: the £45 or so in commission that comparison sites charge for motor cover is much less than it costs to acquire a new customer through TV advertising, points out Ian Williams of Moneysupermarket. Stephen Yap of TMS, a market-research firm, agrees: "Comparison sites have levelled the playing field for small companies. Previously it all depended on advertising budgets; now it's about price."

That means companies bust a gut to get prices down—sometimes at the expense of quality. In a ruse highlighted by Which?, a consumer group, excess payments on insurance policies are set very high in order to keep premiums low. The unremitting focus on headline prices may also explain how 300,000 Britons ended up with their savings in Icesave, a high-paying Icelandic bank that has since collapsed: it led price-comparison lists for months.

The downturn will make price-comparison sites more popular than ever, but they may not benefit much. Though the big sites report increased traffic as people look to cut their bills, the credit crunch has hit them hard. Mortgages, loans and credit cards are a big chunk of business for some sites, and they have got much scarcer of late. Moneysupermarket's shares fell by nearly 60% last summer after one big lender shut up shop, and they have yet to bounce back. Two years ago the site offered more than 30,000 mortgage products; today it has fewer than 3,000. Consumers are not the only ones feeling the pinch.

Britain's children

What ails them?

Feb 5th 2009
From The Economist print edition

Sad, bad and endangered? Hardly, but not all is well

MISERABILISTS' fear of change; idealists' hope for a better world; an all-purpose adult nostalgia for lost youth: all these things ensure a ready hearing for claims that childhood is in crisis. Britons are especially worried. They fear that the young today are sadder than previous generations—stressed, and turned off learning by too much testing. Children may be nastier as well: bullying is "epidemic" in schools, according to one recent survey, and adults routinely describe young people as "feral" and "vermin", says another. And they seem in danger as never before: the killing of Baby P, and the kidnapping of Shannon Matthews by her own mother, have been followed by a rash of tales of child abuse and a big rise in the number of children taken into care.

No wonder a report published on February 2nd by the Children's Society, a charity, entitled "A Good Childhood" and claiming that far too few British children have one, has received widespread notice. Children suffer because adults put their own needs first, the panel concluded, and only a wholesale shift away from competitiveness and individualism can save them. Right-wing commentators agreed with its criticism of single parents and working mothers, left-wing ones with its call for more redistribution of income and less advertising to children. Both overlooked one striking finding: that most children are doing just fine.

Amid the statistics on teenage pregnancy rates (higher than elsewhere in Europe, lower than in America), mental illness (a tenth of 5-16-year-olds are sufferers) and drunkenness (a third of 13-15-year-olds have been drunk at least twice, a share three times higher than the European average), came some more heartening figures: 70% of 11-16-year-olds say they are very, or completely, happy, and only 4% that they are at all unhappy. The report rolls the latter in with the 9% of children who describe themselves as neither happy nor unhappy to claim that 13% are "less than happy", and frets that a further 17% are "only just happy". But clearly, very few children agree with adults that they are in deep trouble.

In "Reclaiming Childhood", published three days earlier, Helene Guldberg, a child psychologist at the Open University, examines the same facts and draws different conclusions. Rising rates of mental illness among the young, she argues, reflect readier diagnosis, and bullying has increased because the word is now used to mean the infliction of even the slightest emotional bruise. She thinks many attempts to improve children's lives, such as alarmist anti-bullying campaigns, and the parenting lessons proposed by the Children's Society, are likely to be counterproductive. "Suggesting that all parents need to be taught how to do their job risks creating a self-fulfilling belief in parents' incompetence and children's lack of resilience," she says. "And if adults tell children that name-calling may scar them for life, then it may."

Britain is no Utopia, of course. As in other rich countries, children find it too easy to sit indoors, staring at screens and overeating. They lack the protection afforded by the Nordic belief in the sacredness of outdoor play, or the shared family meals of Mediterranean countries. A large minority ape their elders' drinking habits (Britons are particularly addicted to drunken benders) and a few, but still too many, become parents while still children themselves.

But overblown claims that childhood is in crisis make life even harder for the few whose lives really are wretched. Social workers are pestered with targets and demoralised by their vilification in the Baby P case. In Haringey, where he died, a quarter of posts for social workers are now unfilled—and across England, one in seven.



Bagehot

Apologise, Gordon

Feb 5th 2009
From The Economist print edition

Why and how the prime minister should say sorry for the recession

Illustration by Steve O'Brien



LIKE some relentless medieval inquisitor or secret policeman, David Cameron keeps at it. Admit it, prime minister, he enjoins, you didn't overcome economic gravity, did you? You led Britain into recession, didn't you? Just as predictably, Gordon Brown insists that the Americans and the bankers dunnit, not he—and that the Tories would "do nothing" to ameliorate the downturn. It would be a lot more edifying, not to mention entertaining, if, instead of denying everything, Mr Brown owned up: if, emulating Jack Nicholson's maniacal Marine colonel in the corny courtroom drama "A Few Good Men", Mr Brown instead replied, "You're goddamn right I didn't abolish boom and bust!"

Considering the verbal contortions the prime minister generally employs to fend off criticism, that seems unlikely. He was at it again in Parliament on February 4th, when he unconvincingly defended his foolish and demagogic (and ideologically uncharacteristic) pledge in 2007 to conjure up "British jobs for British workers". Yet, implausible as it may seem, swallowing his pride, mastering his instinct for self-exculpation and apologising for the recession might be Mr Brown's best hope of political recovery.

There is a moral reason why the prime minister and ex-chancellor of the exchequer might consider apologising. It is that Mr Brown does, in fact, bear some guilt for the economic plunge, certainly for its likely depth and duration—less than the absolute culpability Mr Cameron wants to pin on him, but more than the zero responsibility Mr Brown has thus far been willing to accept. He created the bank-regulation system that failed. He presided over a crazy growth of all kinds of debt; he drove the budget deep into deficit. His ardour for the City left the economy perilously reliant on financial services. He believed his own Utopian propaganda.

Of course, there are mitigating factors, the most important being that many of those errors have become clear only in hindsight. The Tories supported most of Labour's spending plans; scarcely anyone foresaw the credit crunch. Mr Brown is not the first politician to grab credit in good times and deflect the buck in bad ones, nor the only current leader to arraign hostile global forces for domestic woe. All that is enough to acquit the prime minister in some eyes—including, evidently, his own. Accepting that the work of a decade, the glory on which his reputation is based, was flawed, must be almost impossible for Mr Brown.

There is also, however, a more compelling, political reason for Mr Brown to be—or at least seem—apologetic. There are occasions when showing a little calculated contrition can be in the interests of even

the innocent: when confessing obviates a harsher punishment, or when an individual's atonement safeguards a collective. For Mr Brown and his Labour Party, this may be one such.

Mea sort-of culpa

Sir Keith Joseph, one of Margaret Thatcher's ministers and ideologues, often repudiated his past convictions; after one epiphany he announced that for much of his life he had "not really [been a Conservative] at all". Joseph generated respect and amusement in roughly equal measure. But most other politicians adhere to Benjamin Jowett's famous dictum about apologies: never! Under duress, and in suitably lawyerly periphrases, they may, at most, express a compassionate "regret" for something inconsequential that they, or ideally someone else, did a long time ago. (Bagehot recalls a chat with one Labour apparatchik who, pressed to acknowledge the government's manifold imperfections, would concede only that there might have been some flaws in the way Individual Savings Accounts were introduced.)

The explanation for this reticence is simple: self-criticism is an admirable trait in human beings but a potentially fatal one in politicians. A minister who apologises for a big policy error may be lauded for his honesty but sacrifice his credibility. Why should the public trust Mr Brown to get Britain out of its economic hole if he admits to having dug the country into it?

Yet there is a powerful and equally simple counter-argument. It is that Mr Brown's current, resolutely unapologetic approach isn't working. The endless enumeration of recession-busting policies—the "Kirkcaldy telephone directory" method, as one wry observer describes it—just isn't washing, as some in his own party seem to accept. Inflexibly maintaining that no mistakes have been made is undermining public faith in the government's ability to correct them: a large proportion of voters blame Mr Brown for the slump and doubt his remedies for it. Partly as a result of that scepticism, the Tories are (again) consolidating an election-winning margin in the polls.

What Mr Brown needs is to find a tone between adamantine denial and abject prostration, one that bolsters his authority rather than forfeiting it. He could accept that, yes, his economic forecasts of yesteryear may have been too rosy; that he, like everybody else, failed to anticipate the banking collapse; that deregulation and the credit glut went too far. This sort of humility might let Mr Brown appear to participate in the general pain: surrendering his pride might be a better form of kindred suffering than the sleepless overwork that often leaves him looking greyly gaunt. Done skilfully, his could be an apology on behalf of the over-profligate nation as much as to it—in the manner of a penitent husband, who invites his wife for mutual counselling with a view to everyone behaving better in future.

As it happens, there is a very recent precedent for this sort of effective apology. "I screwed up," Barack Obama said with spectacular candour of some of his executive appointments this week, before specifying that the point of saying so was to prevent similar cock-ups in the future. Saying sorry for Britain's recession—perhaps in more nuanced, less demotic terms—might not feel fair to the prime minister. It would be a gift to Mr Cameron; it would be risky. But, the way the economy and national mood are going, for Mr Brown and Labour, not saying it might be riskier.



The World Social Forum

Dear capitalists, admit you got it wrong

Feb 5th 2009 | BELÉM
From The Economist print edition

Buoyed up by a crisis and with five presidents in attendance, the international left has ideas for fixing the world that a neoliberal might recognise

AP



OFTEN mocked for an endless ability to disagree with itself, the World Social Forum—an annual jamboree for NGOs, anti-capitalists, leftish intellectuals, bohemians and bishops—was unusually united this year. More united, in some ways, than the recent World Economic Forum in the Swiss resort of Davos, a gathering of political and corporate bigwigs to which the social forum supposedly responds.

While Davos Man was busy looking for someone to blame for his predicament, no such doubts troubled his opposite number in Belém, a city on the edge of the Brazilian rainforest where mango trees grow so tall that their fruits can shatter car windscreens when they fall. The culprit was the whole current design of the world economy, promoting competition. Free trade and free movement of capital needed to be re-thought, participants insisted. Some even had ideas on what should replace it.

The forum's main purpose is to bring together social movements (which generally dislike being called NGOs) from around the world to network. In that respect, it is rather like any other business conference, though some participants carry spears and wear the feathers of various unfortunate parrots on their heads. The forum is skewed towards Latin America, especially Brazil. One of the founders of the forum is a Brazilian businessman called Oded Grajew, and its first meeting was held in Porto Alegre, in southern Brazil.

Of more than 5,000 accredited organisations, 4,193 were from South America, roughly ten times the number of African outfits present. This partly reflects the number and prominence of NGOs in South America and the semi-official role which some governments give them. This year Brazil's left-leaning government gave the forum a subsidy of R$120m ($52m)—a piece of generosity that was not universally popular at a time when economic growth may be on the verge of halting.

As a result, many causes dear to the Brazilian left were well represented. T-shirts demanded asylum for Cesare Battisti, a left-wing Italian émigré convicted of murder in Rome, who is currently in Brazil. Banners called for Brazilian troops to be withdrawn from Haiti, where they are doing a good job of containing violence.

A proposed hydroelectric dam on the Madeira river (a tributary of the Amazon) was denounced, and the

country's new oil find claimed for its people. Plenty of people came from further afield, like the Catholic Bishops' Conference of India, with a Delphic slogan: "We would rather sweat in peace than bleed in war." And there were swarms of young, largely white folk who treated the forum like a music festival.

This cacophony sometimes sat awkwardly with the presence of five leftish presidents—Fernando Lugo of Paraguay, Rafael Correa of Ecuador, Evo Morales of Bolivia, Hugo Chávez of Venezuela and Luiz Inácio Lula da Silva of Brazil—who dropped in to be fêted. The flurry of helicopters and security men seemed out of place. Four leaders (President Lula was elsewhere) appeared together at a meeting that was billed as a dialogue with the social movements. But the talking was mostly one way. Mr Chávez gave a long, rambling speech in which he struggled to animate the crowd. "Another world is possible! No! Another world is necessary," was as inspiring as it got.

Since its inception, the forum has struggled to get the right balance between a range of attractions: intellectual stars such as Noam Chomsky and Joseph Stiglitz, both of whom have addressed previous meetings; sympathetic politicians; large NGOs and the smaller single-issue organisations which often feel squeezed out.

This tension produced the best exchange in the presidential meeting. "You all talk about doing these things," said João Pedro Stedile, a founder of the Landless Movement in Brazil, "but when you met in Bahia [in December] you just went to the beach." "I didn't go to the beach," muttered the Venezuelan leader. "Well, perhaps those of you who are a bit overweight didn't go," Mr Stedile fired back.

Away from this set-piece spat, people were sitting in meeting rooms and coming up with proposals. The ones that dealt with reforming finance read a bit like a co-production between militant anti-capitalists and more cautious types, which was no accident. At the far edge was the idea that money and finance are public goods and should be shared out accordingly, through democracy. The familiar call for a special tax on international transactions was repeated. But there was plenty of talk that was more moderate and rather more interesting.

The forum suggested that the United Nations should be charged with preventing large trade surpluses and deficits from building up. Controls on exchange rates and the international movement of capital should be re-established. Credit-rating agencies should be reformed, incentives for excessive risk-taking reduced and bankers' bonuses paid on the basis of long-term performance. Hedge funds, private-equity firms and other parts of the shadow banking system should go, along with over-the-counter derivatives (OTCs), collateralised-debt obligations (CDOs) and other nefarious structured products.

In general, a "speculator pays" principle should be introduced and applied when things go wrong. Finally, the world's economy should get a stimulus in the form of a green New Deal.

Bits of this belong to the realm of reality; indeed, they might have come from America's Democratic Party, or even from the op-ed pages of a respectable business daily. Interestingly, the forum proposed an outright ban on subprime mortgages, even though it might have been expected to look favourably on lending to people who would otherwise struggle to get credit.

If some delegates seemed to have thought hard about the economic crisis, the same could not be said of the visiting presidents. After leading the crowd in a chant of "Fidel, Fidel, Fidel!" Mr Chávez joined Messrs Lugo, Morales and Correa in a karaoke rendition of "*Hasta siempre commandante*"—a dirge about the exploits of Che Guevara—before disappearing. That was far too cruel a fate for the assembled company of Asian bishops, indigenous types in all their finery, would-be financial reformers and anti-capitalist warriors.



Cyber-hedonism

Virtual pleasures

Feb 5th 2009
From The Economist print edition

Many young people prefer pleasure-seeking to politics—but for how long?

ONE of the reasons for Barack Obama's electoral success was his campaign's brilliantly effective deployment of young e-communicators. Their tireless use of blogs and social-networking sites helped to generate excitement, collect money, get the vote out and raise political consciousness in America as a whole.

All that was a landmark in the political history of the internet. But the transforming—and at best, liberating—effects of modern communications have been even more dramatic in societies that are poorer and harsher than America: countries where authoritarian regimes and rigid mores had until recently given youngsters little room for manoeuvre.

The question in many internet-watchers' minds is this: as young surfers are exposed to facts, sights, sounds and a range of interlocutors that are far beyond their parents' ken, how will they use that access? Will they try to change the world, or simply settle for enjoying themselves?

There is so much evidence of the latter choice that pundits have invented a new word—cyber-hedonism—to describe it. To the dismay of idealists, young people in many countries seem to be giving up the political struggles of previous generations and opting instead for a sort of digital nirvana, revelling in a vast supply of movies, music, instant communication and of course, sexual opportunity. One appealing thing about cyber-hedonism is that, compared with politics, it's less likely to attract the authorities' attention.

Electronic pastimes for the young range from the innocent to the deadly dangerous. In Nigeria, a best-selling book provides youngsters with tips on "touching the heart through unforgettable text messages". Young Indians have a penchant for browsing marriage sites in search of a good match. Newly weds who would like to celebrate by visiting a famous site, such as the Taj Mahal, can make virtual tours instead. In richer Asian countries—like South Korea or Singapore—there is a passion among the young for online gambling that often becomes addictive. Cyber-hedonism does not, of course, replace real-life flirtation and sex; it merely seems to remove some of the obstacles. Chile has spawned a youth culture known as the Pokémon movement, in which teenagers with odd hairstyles gather to engage in kissing or more. All this—as well as the activity of conservative youth groups that disapprove—is co-ordinated electronically.

In China, two-thirds of the respondents to one opinion poll agreed with the proposition that "It's possible to have real relationships purely online," compared with one-fifth of Americans who felt the same way. But clearly, not all Chinese are content with keeping things virtual: a doctor who runs a pregnancy helpline in Shanghai has said that half the calls she receives come from girls who met boys through the net.

In many countries, the truth is that access to pornography is the biggest factor that draws young men online. First-time visitors to internet cafés in the Middle East or South-East Asia are often surprised to see a male-only clientele, awkwardly protecting their screens from public view. The owners of such cafés know what is happening, but they also realise that cracking down in the name of morality could drive them out of business. In ultra-conservative Saudi Arabia, meanwhile, most of the material passed between teenagers' mobile phones is pornographic.

Political leaders and religious establishments are placed in a dilemma by the rise of cyber-hedonism: do they follow their youngsters onto the net, or try vainly to lure them away from the computer?

In Asia, some politicians have tried to profit from online hedonism by presenting themselves as devotees. In last year's elections in Taiwan, candidates vied to appear internet- and youth-friendly. One hired a spokesman from a heavy-metal band and posted a series of ads on YouTube, the video-sharing site; he

was unfazed by explicit exchanges about a popular erotic film, “Lust, Caution”.

In authoritarian countries with rising living standards—such as Russia and China, until recently—official tolerance of cyber-hedonism has been a sort of Faustian pact offered by the authorities: we will let you enjoy yourselves, in new and unconventional ways, if you keep off politics. But now that economies have turned sour, will the young go on keeping their side of that bargain?

Japan's electronics giants

Unplugged

Feb 5th 2009 | TOKYO
From The Economist print edition

Once the epitome of Japan’s post-war success, its electronics firms are in crisis

Panos



TO SEE the problems facing Japan’s electronics companies, pop into one of the huge gadget shops in Tokyo’s Akihabara district (pictured above), the consumer-electronics capital of the world. Nine domestic firms make mobile phones. Then head over to the appliances section: five of the same firms offer everything from vacuum cleaners to rice cookers. Three of them make the escalators that carry you through the shop. In short, the industry has too many companies selling too broad a range of products that overlap with one another.

This “supermarket” strategy, in which each company has a hand in every area, worked well during Japan’s incredible economic boom between 1960 and 1990. “Made in Japan” gadgets, once cheap and flaky, ended up as world leaders in quality, humiliating America’s electronics industry along the way. Consumers at home and abroad snapped them up, generating vast trade surpluses and bitter trade tensions.

But the companies got bigger and bigger, priding themselves on their girth rather than their profits. Many now have over 500 affiliates, from travel agencies to restaurants. Old practices linger. It is not uncommon for employees to recite the corporate mission in the morning, or stop work in the afternoon as the company song reverberates across the cubicles. LaserDisc players never really caught on after being introduced in 1980, but Pioneer stopped shipping them only last month.

All this could go on for as long as firms accepted low returns on equity. But the global recession is exposing their deep-seated problems with astonishing speed and severity. Demand for consumer electronics has collapsed. The strong yen is crippling exports: the currency has gained 67% against sterling in the past year, and almost 75% against the South Korean won. So Japanese exports—which account for more than half of some firms’ sales—cost more to foreign buyers. Meanwhile, component prices are plunging, overcapacity is rife and margins are meagre. Apple’s iPhone is stuffed with Japanese parts, but most earn their makers a return of less than 5%.

Having predicted full-year profits only three months ago, the giants are now forecasting massive losses. Sony expects an operating loss of ¥260 billion ($2.6 billion). Its Welsh boss, Sir Howard Stringer, is fighting to overcome internal resistance as he tries to restructure the firm. He wants to close factories and cut over 16,000 jobs including, controversially, some staff who expected lifetime employment. He has been trying to push through many of these changes since his appointment in 2005. But only now can he

get his way. At a news conference on January 29th Sir Howard said Sony had been "putting off unpleasant decisions" and now had to "move in a hurry". The same is true of Sony's rivals.

Panasonic is expected to post a net loss of ¥380 billion loss for 2008. Hitachi and Toshiba, which make everything from nuclear reactors to the toasters they power, have been hit by the collapse in sales of microchips. Hitachi's loss is expected to be ¥700 billion, and Toshiba's ¥280 billion. Sharp, NEC and Fujitsu are also expected to lose money. In a damning sign of the times, Fujitsu's bosses recently called upon the firm's 100,000 employees in Japan to buy its goods. This week shares in Hitachi and NEC fell to their lowest levels for three decades. All this seems to have prodded the giants into action: all have announced job cuts and factory closures of extraordinary brutality by Japanese standards.

Better late than never

Privately, senior executives have long known that their companies were in crisis. But like Sir Howard, they faced strong internal resistance to change. Bosses were reluctant to cut projects initiated by their predecessors to whom they owed their jobs, to axe superfluous divisions, or to abandon cosy relationships with trusted suppliers. With docile domestic investors and a network of friendly cross-shareholdings, there was little outside pressure to restructure. Besides, samurai believe it is better to fight to a tragic and noble end than to surrender (which, in the corporate world, is equated with being acquired).

There were signs of change in December when Panasonic agreed to buy a majority stake in Sanyo Electric for around $9 billion. Struggling Sanyo had been whittled down by three banks that had bailed it out three years earlier (including a foreign one, Goldman Sachs). Panasonic gets Sanyo's respected battery and solar technology, but must still "throw out the sinking trash," in the words of one banker. The pity is that no one expects the deal to signal further consolidation. Panasonic (called Matsushita until it adopted its best-known brand as its corporate name last year) had great difficulty combining two of its divisions in 2004. Bringing Sanyo into the fold will be even harder.

Instead of consolidation, companies have been pursuing a strategy of "internal M&A", in which business units are shut down or sold to other firms, so that each company ends up more focused. Fujitsu, for example, hopes to unload its loss-making hard-disk business, but it recently took full control of a joint-venture to sell computers as part of a push into computer-related services. Sony, which is concentrating on media technology, sold its "Cell" chip unit to Toshiba, which is specialising in semiconductors. Sharp and Pioneer have formed an alliance to unite their LCD and audio technologies.

This process will intensify as companies make deeper cuts. But will it be enough, given that domestic demand for electronics is shrinking fast and foreign rivals are taking market share elsewhere? South Korea's Samsung and LG in televisions, and China's Haier in home appliances, threaten to do to Japan what Japan did to America, by producing high-quality products at low prices.

The long-term answer, Japanese bosses believe, is to move into clean technologies such as solar panels and electric-car batteries—new areas where Japanese firms are already strong. The government's new stimulus package reintroduces a subsidy for green technologies to encourage such a shift. With the exception of the South Korean conglomerates, few other firms have the research-and-development resources to compete in these areas. But the Japanese companies' size is also a disadvantage. Investors who want to bet on solar power or electric cars do not want to be saddled with rice cookers or restaurants. At last, it seems, the giants have realised this.

Japan's labour market

Non-regular and not wanted

Feb 5th 2009 | TOKYO
From The Economist print edition

Japan's floating workforce is particularly vulnerable in the downturn

AP


Regular meals for non-regular workers

AFTER clashes between riot police and protesters, workers at the Keihin Hotel in Tokyo were forcibly ejected on January 25th. They had been fired in October when the hotel went bust, but decided to keep it running—an example of the lengths to which people will go to keep their jobs in Japan, where unemployment is suddenly rising at an alarming rate. Over 150,000 people are expected to lose their jobs between October and March. Hisashi Yamada of the Japan Research Institute expects 1.5m job losses by the end of 2010, lifting the unemployment rate from 4% last year to over 6%. Though low by international standards, that is exceptionally high in Japan.

Hardest hit will be "non-regular" workers—those who work part-time, as day-labourers, for a fixed duration, or under agency contracts. "Regular" workers enjoy benefits such as housing, bonuses, training and (usually) lifetime employment, but non-regular workers earn as little as 40% of the pay for the same work, and do not receive training, pensions or unemployment insurance. In the past 20 years their numbers have grown to one-third of all workers.

For years most Japanese ignored their plight. But now their problems have erupted into plain sight. In January around 500 recently fired, homeless people set up a tent village in Hibiya Park—a highly visible spot in the centre of Tokyo. Politicians and television news crews flocked to the scene. The embarrassed city government eventually found accommodation for the park's homeless in unused city-owned buildings, though it put them up for only a week.

The problem is that Japan lacks a social safety net, says Makoto Yuasa, the organiser of the Hibiya tent village, who dropped out of a PhD programme at Tokyo University to help homeless people. Because families or companies traditionally looked after people, the state did not have to. Moreover, there is a stigma in Japan if an unemployed person asks for help: "If you don't work, you don't deserve to eat", the saying goes.

Yet there are signs of change. The main political parties recognise the need to establish better support and training for non-regular workers. And there is even a new government programme to help unemployed foreign workers, such as Brazilians who worked at car factories, so that they do not leave Japan if they are laid off. With a shrinking population and workforce, losing skilled hands would only compound the country's woes when the economy eventually recovers.

Executive pay

Paying the piper

Feb 5th 2009 | NEW YORK
From The Economist print edition

Will Barack Obama's reform of executive pay work?

CREATING political theatre by cracking down on executive pay may prove to be the easy part for Barack Obama. Coming up with a sensible and effective way to compensate senior managers at companies bailed out by the American taxpayer will be far trickier—and the new president's first effort, unveiled on February 4th, is unlikely to be his last.

Capping the non-equity-based remuneration of executives in companies receiving "exceptional assistance" at $500,000 a year and banning "golden parachutes" for failed executives is likely to strike most Americans as fair, or even generous, given that Mr Obama himself earns a mere $400,000 and the rules will apply only to new bail-outs. Indeed, after the outrageous payment of billions of dollars in bonuses by Wall Street firms that had survived only because many more billions had been injected into them by the government, the executives should probably be grateful for getting off so lightly. Moreover, executives will be allowed grants of restricted stock (which they cannot sell until the taxpayer is repaid), so they may yet end up making a fortune.

Last time a president tried to curb fat-cat salaries was in 1993, when Bill Clinton signed a law restricting the tax deductibility of executive pay to $1m. This merely prompted a burst of creativity. Perks were devised that got around the cap, and there was a boom in paying executives with shares and options that, thanks to the bull stockmarket of the 1990s, made everybody far wealthier than they would have been using the old pay formulae.

Mr Obama has the dubious advantage of trying to cap pay amid a severe economic downturn, rising unemployment and structural changes in finance that will reduce pay anyway. A recent study of Wall Street pay, carried out by Thomas Philippon and Ariell Reshef for the National Bureau of Economic Research, found several periods during 1909-2006 when remuneration plunged, and argued that now could be another such period.

Nonetheless, even in these tough times, talented bankers are likely to find opportunities elsewhere that promise far more than $500,000. And even those that do not leave may simply choose to work less hard, says Alan Johnson, a pay consultant. As a result the new rules may weaken the management of rescued banks—just as low pay arguably weakened regulation and helped cause the financial crisis.

Will Mr Obama's message to bosses that they have "got responsibilities not to live high on the hog" lead to restraint in executive pay more broadly? Ira Kay of Watson Wyatt, a pay consultant, thinks it might, because rising pay on Wall Street in recent years led to higher pay elsewhere—a trend that may now operate in reverse.

In the long run, the more significant change may be Mr Obama's decision to give American shareholders a vote on executive compensation, through a "say on pay" resolution. A vote is certainly more sensible than a crude government limit—especially if it is extended to all public companies, not just those bailed out by Uncle Sam. A similar reform is reckoned to have made at least some difference in Britain, and not before time.

Mining

Digging deep

Feb 5th 2009
From The Economist print edition

Miners lead the rush to raise equity

IT IS supposed to be the canary's job to give the warning, but this time the miners have done it themselves. Anyone who doubted that a surge in equity issuance from indebted companies is coming should recant after events in the mining industry. Since January 26th three leading firms—Rio Tinto, Freeport-McMoRan and Xstrata—have indicated that they will probably try to raise equity in one form or another. Together they could target as much as $17 billion, lopping a fair chunk from their combined net debt of $62 billion, and equivalent to just over a quarter of their stockmarket value.

Why miners? All three firms have high borrowing, in large part due to overpriced acquisitions they made during the boom years. Indeed, Freeport also announced that it was writing off half of the $26 billion it paid for Phelps Dodge in 2007, and Rio will surely have to write down Alcan, which it bought for $38 billion in the same year. But all three had reasonable liquidity and could have hunkered down for at least another year. Perhaps they reacted more quickly than other firms because the damage a downturn does to miners' earnings is immediate. Denial is not an option.

Despite being first out of the blocks, Xstrata and Rio Tinto show just how tortuous it is to raise equity when investors have been hammered and may face liquidity problems of their own. Xstrata's founding 35% shareholder Glencore, a privately held trading firm, lacks the cash to take part in the $5.9 billion rights issue. To fill Glencore's pockets, Xstrata has agreed to buy a Colombian mine from it, and to give it the option to buy it back within a year. In effect Xstrata is lending Glencore money with the mine as collateral. The deal's fine print looks reasonable, but corporate-governance watchers are not amused.

If Xstrata's deal involves helping an old friend, Rio is supping with its toughest customers. It is wondering whether to take an investment from Chinalco, China's state-controlled aluminium firm, in place of a rights issue. A year ago Chinalco hugely overpaid for a 9% stake in Rio, which has a dual listing in London and Sydney. This time the Chinese firm could buy convertible bonds or direct equity stakes in mines.

Unless the price is extraordinarily high, it is hard to see why Rio would prefer this to a rights issue, however arduous. China is one of Rio's biggest customers, responsible for one-sixth of sales, and has a political interest in pushing down the price of its raw-material imports. Chinalco's presence has the potential to create a big conflict of interest, which is why Australia's government may block a straightforward equity purchase. A deal might also end up acting as a poison pill for other potential acquirers. To overcome these big drawbacks Rio would have to exhibit a degree of dealmaking skill that has so far eluded it.

The sheer pain of raising equity right now is one lesson from the miners' experience. The other is just how good it feels to be looking on with a solid balance sheet. Anglo American, BHP Billiton (which pulled out of a takeover of Rio, citing its debt) and Brazil's Vale (which raised $11 billion of equity in mid-2008) all have low gearing. That will allow them to drive home their advantage during this downturn by buying assets. Vale has, in fact, already picked up some from Rio. It also gives them the flexibility to maintain capital spending. On February 4th BHP said its budget next fiscal year would fall by only 13%. Cuts of over 50% are the order of the day for the three indebted miners, hurting their long-term growth.

The mining industry has cut capacity remarkably quickly: global capex this year could be half the level of 2008. That should help stabilise commodity prices, particularly if, as many hope, demand from China holds up courtesy of its government stimulus. Yet already this downturn seems to have created winners and losers, with balance-sheet strength the differentiating factor. The same is likely to happen in many other industries, too.

The rise of haggling

Let's make a deal

Feb 5th 2009 | NEW YORK
From The Economist print edition

Cash-strapped consumers are haggling their way to big savings

THE Baccarat chandeliers and gleaming marble floors of New York's Plaza Hotel would appear to have little in common with the cramped stalls of a Yemeni market. But in both, bargaining can lead to a better deal. The bad economy has made the Plaza more flexible, and if the price of a room sounds steep, would-be guests can negotiate it down. The hotel may even throw in free cocktails to sweeten the deal.

The hotel business is reeling as firms and families cut their travel budgets. But it is not the only industry that has become more willing to grant discounts to confident hagglers. Clothes and electronics shops have become particularly eager to move their merchandise, and consumers, aware of their desperation, have grown bolder. According to America's Research Group, a market-research firm, 72% of American consumers have haggled in the past four months, compared with 56% a year earlier. Britt Beemer, the firm's chief executive, estimates that they are successful 80% of the time.

Hunting for a bargain may be rooted in the American shopping experience, but haggling is not. Now that even big department stores such as Nordstrom will listen to customers trying to cut a deal, however, haggling is becoming more accepted, at least for as long as the recession grinds on. Even if they cannot get a discount, shoppers can ask for another item to be thrown in, or for the retailer to pay the shipping costs or the sales tax.

Haggling works best in hard-hit industries: car dealers are more willing than ever to hammer out a bargain now that sales have slumped, and property brokers will cut prices and fees when pushed. But the trend is spreading. Providers of phone and internet services are willing to cut monthly rates to keep customers from cancelling or switching. Richard Zeckhauser of Harvard Business School expects prospective students to negotiate more financial aid from universities. If they have the strength, patients can also haggle over medical bills.

Credit-card companies are being more flexible with customers who want interest rates reduced or late fees waived. Curtis Arnold, author of “How You Can Profit From Credit Cards”, says more companies are creating “hardship programmes” that they tell consumers about only once they try to haggle.

In the long term, firms may suffer if American consumers get used to the idea of all this horse-trading. But in the short term, it could prop up sales. In New York's deserted shops, a haggler is better than no customer at all.

Outsourcing

A quick fix

Feb 5th 2009
From The Economist print edition

Companies are seeking outsiders' help to squeeze more out of their equipment

AS CAR dealers know only too well, the global downturn has made people think twice before splashing out on pricey new machines. Instead they are trying to make their existing sets of wheels last longer. Like car owners, managers faced with a cash crunch are also keen to get as much extra mileage as possible out of their existing equipment rather than buying costly new gear. To do so, some have been turning to "asset maintenance" companies, which specialise in taking over all or part of a firm's servicing activities and then running them more efficiently.

"Downturns have always been good for the maintenance-service business," says Jari Kaija, the head of the global service arm of ABB, a Swiss-Swedish firm that is one of the biggest in the asset-maintenance field. This slump is unlikely to break that rule. A recent study by Frost & Sullivan, a research firm, predicts that the $125 billion market for outsourced-maintenance services in North America will continue to grow as firms push ageing machines to their limits on the one hand, and try to reduce head count on the other.

More deals are likely in Europe, too. In January ABB kicked off what it claims is the biggest-ever outsourced-maintenance agreement in the pulp-and-paper industry. Together with Stora Enso, a Finnish paper-products firm, it has set up a joint venture to take over servicing and repairs at six of Stora's Finnish mills. Some 1,450 of Stora's staff have been transferred to the new company, which is expected to have up to $270m a year in revenues. Stora has been badly battered by the downturn and urgently needs to cut costs. On February 5th the company announced that it made a net loss of €675m ($988m) in 2008, following a net loss of €212m in 2007.

Outsourcing firms such as ABB and Advanced Technology Services (ATS), an American company, promise to help clients save money not only by offloading repair workers, but also by getting remaining ones to work better. They can reduce costs by consolidating spare-parts suppliers, introducing more sophisticated machine-monitoring systems and encouraging better forward-planning and co-operation between engineering and production staff. Rod Bayliss, a manager who oversees outsourced maintenance for Eaton, an American industrial company with $15 billion in annual sales, says ATS has helped it anticipate problems with machinery.

Outsourcing firms sometimes discover that their clients are spending too much to keep machines up and running. "It's often engineers at play," quips Andrew Jardine, the director of the Centre for Maintenance Optimisation and Reliability Engineering at the University of Toronto. Bill Wasilewski of Fluor, another American asset-maintenance firm, says it sometimes has to persuade clients that occasional breakdowns are acceptable because the cost of preventive maintenance turns out to be far greater than the cost of lost production when a machine temporarily fails.

The downturn means that many factories are lying idle. Some bosses may be tempted to axe maintenance work—and workers—altogether, because they have plenty of spare capacity. But that could be risky. For one thing, mothballed plants may suddenly need to be brought back to life if demand shifts. Getting them running again will be much more difficult if equipment has been neglected. For another, firms could all too easily lose vital knowledge that is locked up in the heads of their in-house repair folk. That really would throw a spanner in the works.

Online video

Hulu who?

Feb 5th 2009 | SAN FRANCISCO
From The Economist print edition

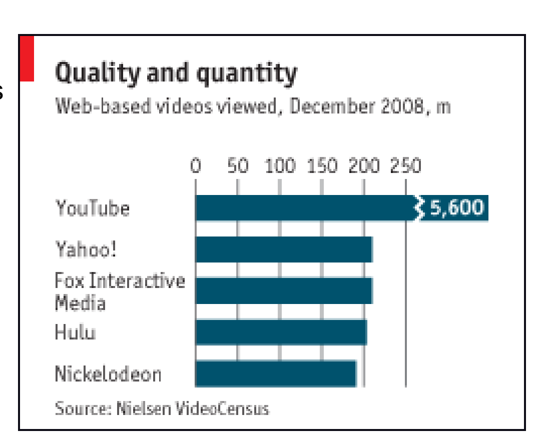
After much confusion, it is becoming clear what works in online video

IN THE spring of 2007 Jason Kilar was trying to beef up the video offerings of his employer, Amazon, the world's largest online retailer, when he got a call from a headhunting firm. Would he consider running Hulu, a new joint venture by two "old media" giants, NBC Universal and News Corp? The idea was to enter the confusing online-video market by starting a service from scratch—and doing it properly. Mr Kilar said yes. He showed up in his new office in Santa Monica, near Los Angeles, and with his small team started scribbling ideas on the "whiteboard" wallpaper.

The excitement as well as the confusion had started in 2006, when a young website, YouTube, shot out of nowhere to become that year's "next big thing". Within months, YouTube sold itself to Google, the world's largest internet firm. YouTube had risen so fast by making it easy to watch and share videos in any web browser, and by making it almost as easy to upload home-made videos to its site. Such "user-generated content" seemed to be the future.

In one sense this turned out to be correct. YouTube went on to dominate web video as measured by the number of videos that users watch (see chart). Its social and even political importance are hard to overstate. From "Obama Girl" videos and tutorials about tying shoelaces or folding origami to Yoga and aerobics instruction, YouTube has changed lives. But there was a catch. Advertisers, by and large, will not touch user-generated content with a barge pole. Its quality is variable, to say the least; its content occasionally off-putting. No brand wants to be near it. And much of it is illegal—pirated from large media companies and uploaded by fans. Media giants, led by Viacom, were suing. So there was a threat of costs and no promise of revenues. YouTube is undoubtedly a phenomenon, but it is not a business.

So others showed up hoping to fill that gap. Until recently, says Shahid Khan, a video analyst at IBB Consulting, there were only question-marks. Did a new service need user-generated content as well as professional videos? Was it better to aggregate the content of many media companies or to be an outlet for just one? Would people prefer to download films or television shows to their computers, then transfer them to their iPods, as Apple was betting? Or would they prefer "streaming" a video just once? If so, might they be persuaded to install a bespoke video application onto their computers, or would they insist on watching videos inside their web browsers? Would they pay to watch, or would advertising provide the revenues?



Almost every permutation has been tried. From Amazon to Apple, from Netflix to Joost, from ABC to CBS's TV.com, companies old and young started serving videos over the internet. Into this mess Mr Kilar tried to enter with the service that was to be Hulu. The bloggers at first scoffed: it turns out that Hulu can mean "cease and desist" in Swahili. But then they started paying attention.

Tune in for the answers

Today, even though advertising is destined for a depression, Hulu appears to have clarified much of the confusion. Mr Kilar will not say what revenue or profit Hulu is making. But it seems to be successful by any measure. Although Hulu is still far behind YouTube (see chart), users have been flocking to it, watching 216m videos in December. Just as importantly, Hulu's inventory for advertisers appears to be sold out. So Hulu is in the rare position of being able to increase inventory (through new content and more views) and make money from it. Hulu now has more than 100 advertisers, including big brands such as McDonald's, Bank of America and Best Buy.

It therefore appears that Mr Kilar has, in effect, answered a lot of the questions. He contemplated user-generated content, then decided that “the world didn’t need yet another” YouTube; so Hulu has only professional content, and advertisers love it. He also talked with his bosses at NBC Universal and Fox and agreed that aggregating the content of many was “something potentially much larger” than piping out the videos of just two. Hulu now offers content from more than 110 partners.

Mr Kilar also bet on streaming via the web, rather than letting users download. Rivals such as Joost have made the same choice. Films and TV differ from music, says Mike Volpi, Joost’s boss, in that people watching tend to sit still, whereas people listening tend to move; and people usually watch a show only once but listen to a song again and again. There is a place for Apple’s model of downloading and buying videos—children, for example, like to watch the same TV programme many times—but that market is likely to be smaller.

Mr Kilar was also early to choose the right way of streaming video: through the browser, with a simple and sleek design. He began, he says, with the idea that the site should “not look like Tokyo at night”—in other words, it should be as simple as YouTube is cluttered. And the service should be so easy to use that “my mother would be proficient on it in 15 seconds or less, with no help from me.” Mr Kilar, who began his career at Walt Disney, wanted Hulu to offer the same rich-but-clean experience as Disney’s theme parks do.

Accordingly, he decided against making users download a special piece of software, which would not have “passed the mom test.” This turned out to be correct. Joost started by offering video through its own software application, but lost out to Hulu and did an about-face. A few weeks ago it discontinued its downloadable application and began streaming only through the browser. This late conversion was Joost’s “biggest flaw”, says IBB’s Mr Khan, and now leaves it far behind.

The browser-based approach favours streaming rather than downloads, but that does not mean that the paid-for download model is dead. Mr Khan thinks that some viewers will want to own content, and that may become a premium option on free services such as Hulu.

But the bigger lesson from Hulu’s success is that supporting streamed video with advertising, rather than charging for downloads, turns out to work very well. Hulu’s ads are few and short, with a subtle countdown timer that makes them even more bearable. In some cases viewers can even choose which ad to watch, so it is more likely to be relevant to their interests. And people tend to remember the advertisements they see on Hulu much better than they recall television ads, says Mr Kilar, so advertisers are pleased.

It is too early to declare Hulu the winner. It “has done a very good job,” admits Joost’s Mr Volpi, but “the die has not been cast yet.” Mr Khan thinks Amazon’s offering may become more compelling, and that TV.com, formerly a provider of television listings and now a streaming site owned by CBS, may yet come from behind. But for the moment it appears that YouTube proved that people would watch videos online—whereas Hulu is proving that advertisers will foot the bill.

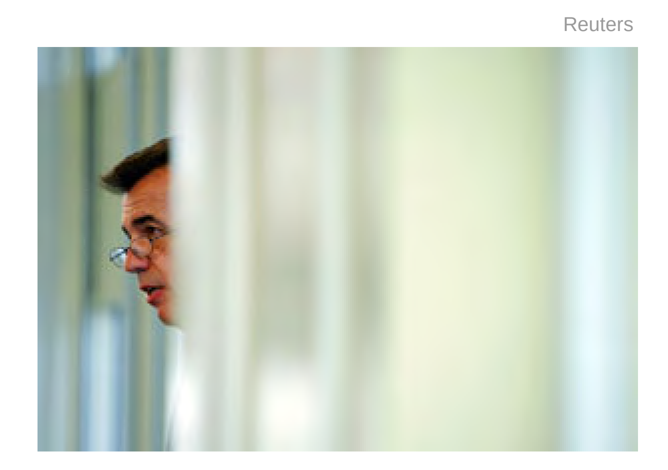
Face value

The unrepentant salesman

Feb 5th 2009
From The Economist print edition

As rivals rush to acquire other drugs firms, David Brennan, boss of Britain’s AstraZeneca, looks to China

Reuters



IT SEEMS the floodgates are about to open for another wave of pharmaceuticals mergers. The $68 billion deal announced on January 26th by America’s Pfizer to acquire Wyeth, a middle-sized compatriot, was the catalyst. Soon afterwards Switzerland’s Roche decided to abandon its previously friendly overtures toward Genentech, a Californian biotechnology pioneer, in favour of a hostile takeover bid. Now Sanofi-Aventis is openly talking about making a big acquisition, as is Merck. And yet here is David Brennan, chief executive of Britain’s AstraZeneca, coolly remaining above the fray. When his firm announced its annual results on January 29th, he went so far as to declare that it definitely does not “need a merger or significant acquisition.”

Perhaps such self-confidence is justified. AstraZeneca’s full-year revenues for 2008 increased by 7% to $31.6 billion, once adjusted for exchange-rate fluctuations. The firm also posted a 9% increase in profits over 2007, to $6.1 billion. Its shares were among the best-performing in Britain’s benchmark FTSE 100 index last year. Even so, Mr Brennan’s firm faces the same difficulties as the rest of the industry: a flagging product pipeline and looming competition from generic versions of its patented drugs. A new report from ING, an investment bank, warns that as the patents on AstraZeneca’s blockbusters expire in the coming years the firm risks going into “intellectual property meltdown”. Other industry chiefs, confronted by a similar crunch, regard big mergers as a good way to replenish pipelines and slash costs.

But not Mr Brennan. Unlike many drugs bosses, who are scientists, he has a background in sales. When asked about his management philosophy he reflexively turns to personal lessons learnt as a junior sales manager, or anecdotes from the field. So how does he plan to save AstraZeneca, if not through the merger mania now intoxicating his rivals? His strategy has three prongs, each of which benefits from his firm’s growing presence in big emerging markets: reduce costs at home, increase sales in developing countries and spark innovation.

Mr Brennan insists that good managers do not need mergers to squeeze out efficiencies. AstraZeneca is in the midst of shedding some 15,000 jobs over five years, in the hope of cutting costs by $2.5 billion a year. It is also shifting manufacturing to developing countries, something Western drugs giants have usually been reluctant to do, given concerns about quality and intellectual-property protection. It is a sign of how far both China and the industry have come that Mr Brennan travelled to Wuxi, a city a few hours outside Shanghai, in January to celebrate the expansion of a factory there. Originally built to supply the Chinese market, the larger plant will produce drugs to be sold throughout Asia. The facilities are world class, but the cost of production is less than half that in the developed world. By 2012 or 2013 the firm plans to export to Europe, and in ten years it expects that as much as a quarter of its global output may come from China.

The second aspect of Mr Brennan's plan is to pursue growth in big emerging markets, especially China, where AstraZeneca is doing well. It jostles with Germany's Bayer for the biggest market share among foreign drugs firms in the country's $19 billion market for modern pharmaceuticals. And in recent years its sales have grown faster than the industry average. This is partly due to AstraZeneca's sales push into China a decade ago. But its continued success owes much to Mr Brennan's background in sales, and his readiness to trust the instincts of local sales managers in far-flung markets—in contrast to the centralised approach taken by most big rivals. When his country manager in China wanted to alter the global marketing plan for a blockbuster gastro-intestinal drug to suit local conditions, for example, Mr Brennan agreed immediately. "We don't hand money to our Chinese team and force them to do what worked in Brazil," he says.

Peddling pills, proudly

In much of the Western world, drugs companies are under attack for spending too much money on sales conferences and promotional visits to doctors, rather than research. But Mr Brennan stoutly defends such practices, and industry observers credit his firm's diligent execution of old-fashioned sales and marketing in remote bits of China for its booming sales. Mr Brennan says the seminars run by Western firms like his, and the scientific studies disseminated by his salesmen, help educate doctors in countries that lack a tradition of modern medical education. That is a self-serving argument, since such tactics also drum up sales, but not necessarily a false one. Rachel Lee of the Boston Consulting Group thinks firms like AstraZeneca bring much-needed professionalism to China's drugs industry, once dominated by local generics firms notorious for relying on cronyism and kickbacks. Western firms are, she suggests, thus helping Chinese doctors shift towards "evidence based" medicine.

And that in turn points to the third pillar of Mr Brennan's strategy: sparking innovation in-house by making targeted biotech acquisitions, including MedImmune and Cambridge Antibody Technology. But AstraZeneca has also set up a research centre outside Shanghai crammed with advanced drug-discovery tools. The firm discovered by accident that a lung-cancer drug that flopped among Caucasians worked well in many Chinese. Now local researchers are trying to find out why.

Will Mr Brennan's bet on China pay off? Its growth has slowed rapidly of late, and the market is still tiny compared with America. Moreover, technology leapfrogs in some areas may mask ropy infrastructure or cultural gaps in others. As Mr Brennan toured his firm's Chinese research centre, local managers beamed as they showed off a digital scanner here and a sparkling clean-room there. But then one manager threw open a door with fanfare and proudly declared, "We've even got two fax machines in this area!" Mr Brennan, ever the salesman, smiled gamely.

Economist.com OPINION

Globalisation under strain

Homeward bound

Feb 5th 2009
From The Economist print edition

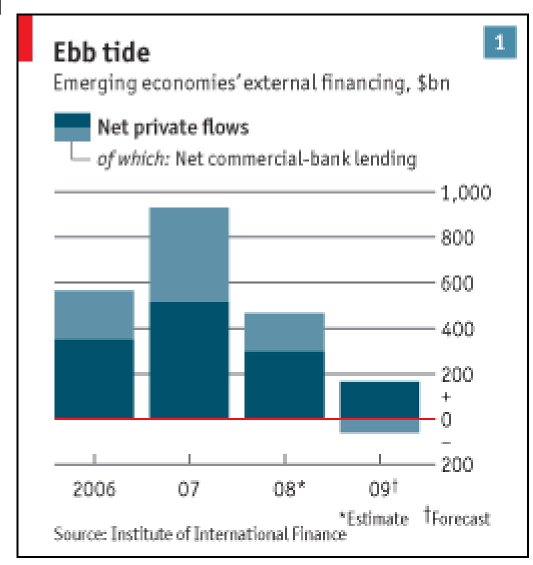
A great financial retrenchment is under way, the product of both market forces and political pressure on banks to lend at home rather than abroad. In other industries (see article) globalisation looks harder to unpick

Frazer Hudson



AT THE annual pilgrimage to Davos last month, politicians were united in agreement: the biggest danger facing the world economy is protectionism. Many of the mountaintop sermons picked out the risk of financial mercantilism, a reflux of capital from foreign markets to home ones. Gordon Brown, Britain's prime minister, preached against a "retreat into domestic lending and domestic financial markets". But back in the real world the barriers to the free flow of capital are rising fast. Are the politicians hypocrites, toothless or misguided? A bit of all three.

That a retrenchment in cross-border credit is under way is beyond doubt. In Mr Brown's Britain, data from the Bank of England show that in the fourth quarter of 2008 local banks sharply cut lending to foreign customers. British borrowers are themselves suffering from the withdrawal of Icelandic, Irish and other foreign lenders, which provided a big chunk of their credit at the peak of the bubble. The Australian government is creating a A$4 billion ($2.6 billion) fund to tide over commercial-property investors who cannot renew foreign debt. Corporate borrowers in many markets are about to put their foreign bank creditors to the test, as they prepare to refinance syndicated-loan facilities.



Things are worse in emerging markets. Projections from the Institute of International Finance (IIF), an industry group, show that net inflows of private capital will slow to $165 billion this year, down from a peak of $929 billion in 2007. Much of that retreat is happening in the capital markets, but the banks are fleeing fastest. The IIF forecasts a net outflow of bank funds from developing countries this year, as borrowers repay more debt than they take out (see chart 1).

Central and eastern Europe is under the greatest strain, having binged on international borrowing in recent years. Relative to GDP, foreign banks' assets in the region far exceed those in emerging Asian markets at the time of the crisis that swept across Asia in the late 1990s (see chart 2). In places such as Russia and Ukraine, local banks that had relied on borrowing abroad to finance their expansion were the first to suffer when credit dried up.

Banks with foreign parents are also feeling the pinch. “The idea that foreign ownership would help to keep the tap turned on worked until the fourth quarter of 2008,” says Simon Nellis of Citigroup. At least one foreign bank in the region has been asked to make a formal commitment to provide liquidity if its local unit gets into trouble. Last month Western banks and multilateral bodies such as the European Bank for Reconstruction and Development launched separate initiatives to secure extra money for eastern Europe.

The imponderable is just how much this retraction in banks’ foreign lending owes to political pressure to focus credit on domestic customers. “The natural operation of the system has the same effect as financial nationalism,” says David Mayes of the University of Auckland.

Banks are shrinking their balance-sheets everywhere, after all. And they have sound commercial reasons to concentrate on their home markets. One is the scarcity of capital. Among the few ways that banks can still raise money without hurting their long-term prospects is selling non-core assets abroad: Royal Bank of Scotland, UBS and Bank of America have all decided to offload stakes in Chinese banks. (Things are different for Western banks with well-developed franchises in emerging markets—their executives insist that they remain committed to these subsidiaries, even if growth is slowing as they become more selective.)

The devil you know

Another reason to look inward is rising credit risk. Such risk is easier to handle in home markets, where lenders can draw on better insight and data. According to Julian van Kan of BNP Paribas, the Basel 2 accords on bank capital also encourage retrenchment by levying higher capital charges on emerging-market assets. Some lending in central and eastern Europe has been particularly dodgy. According to the Bank for International Settlements, foreign-currency lending, much of it to households at long maturities and unhedged, represents between 40% and 55% of the total in places such as Hungary and Romania.

So politicians may not be able to stop the drying-up of cross-border credit. Then again, there is little sign that they want to. Many are employing what one banker terms the “moral suasion” of repeated calls to lend more at home. Last month George Provopoulos, the governor of Greece’s central bank, warned Greek banks not to send rescue funds abroad. Banks that have not taken taxpayers’ money can resist this more easily than others—Barclays has been left alone to get on with integrating its acquisition of the American bit of Lehman Brothers, for instance. But the reputational risks of foreign expansion in this climate are bound to weigh on all boardrooms.

State support is increasingly accompanied by explicit obligations to lend at home. The Obama administration has signalled that it will require American banks that benefit from its forthcoming rescue package to lend more. French banks that tap government assistance have pledged to increase lending by 3-4% annually. ING, a Dutch bank, which announced another round of government assistance on January 26th, promised to extend €25 billion ($32 billion) to Dutch businesses and consumers in return. “You expect a nationalistic element when private actors have been replaced by national ones,” says John Hele, ING’s finance director.

An unsavoury odour

This is economic nationalism, but of an insidious type. Western governments are not trying to keep foreign banks out of their markets: indeed, foreign credit would be welcome. But the purpose is to steer banks towards supporting businesses and jobs at home, not abroad. That has the whiff of protectionism about it.

The competition authorities are not sure what to make of it. The reason why Europe’s bank-recapitalisation schemes have been approved by the European Commission is that banks play a critical role in the economy: increased lending justifies intervention. Using taxpayers’ money to bulk up abroad would be frowned on. Concerns that state money would enable BNP Paribas to finance its proposed acquisition of the Belgian bits of Fortis gave commission officials pause when they first reviewed France’s bail-out scheme.

Such worries are only likely to increase. Some rivals are already complaining about ING’s ability to gather deposits in their markets now that it is clearly in the lee of the state. It is “unbearable”, sighs one French

banker. (The Dutch bank points out that lots of institutions have state backing and that it is doing nothing that it was not doing a year ago.)

The short-term phenomenon of financial nationalism may be driven by the market as much as by politicians. However, that is not so of the long-term threat to cross-border capital flows: the changes that regulators make to the landscape for multinational banks, especially in Europe.

Changes there will be, thanks largely to the failure of Iceland's banks last year. Their implosion, after years of rapid expansion abroad, rammed home the unpleasant truth that banks may be global in life but are national in death. Depositors in other countries, who were entitled to compensation from the Icelandic deposit-insurance fund, found that the pot in Reykjavik was too small to pay them when the banks went bust. Their own governments had to step in. "It is hard to overstate the damage that Iceland did to the trust among regulators," says Bob Penn of Allen & Overy, a law firm. "It made real problems that until then had only existed in theory."

One answer is to bring regulators of foreign parents and their local subsidiaries closer together, perhaps even to create a single supervisor of cross-border banks. A review of European arrangements, led by Jacques de Larosière, a former managing director of the IMF, is due to deliver its initial recommendations later this month. The question of how to regulate big global banks is also on the agenda of the G20 countries. Many observers doubt that radical proposals are in the works, however, because of touchiness about sovereignty. And the evidence to date suggests that regulators are focusing on tending their own turf, not sharing it with others.

Regulators in Switzerland have introduced a new capital regime for UBS and Credit Suisse, the country's two biggest banks, which restricts their total leverage as well as measuring their risk-weighted assets. Nothing wrong with that, except that the leverage ratio explicitly excludes lending the banks undertake domestically from calculations of capital. Reducing the amount of foreign assets that Swiss banks hold is sensible but privileging domestic lending so flagrantly is alarming.

The Financial Services Authority (FSA), Britain's financial regulator, has also been busy, issuing new proposals on the management of liquidity by banks (including branches of foreign institutions) in its domain. The proposals are designed to make banks more self-sufficient if disaster strikes a parent. The FSA says it may grant waivers to these rules, but only if a bank's main supervisor takes an equally firm approach. That makes it far likelier that others will follow its lead.

New rules on liquidity are certainly needed—the Basel Committee of bank regulators is also at work on a scheme—but they threaten to reverse two important trends in European banking over the past two decades. The first is centralised liquidity management, enabling cross-border banks to move money between different territories as needs demand. The FSA rules may prefigure a world where large pools of liquidity and capital remain trapped within borders as insurance against the worst. That is not just inefficient; it could exacerbate problems if money were stuck in one place but urgently needed in another.

The second trend is the responsibility that has increasingly been entrusted by branch supervisors (the "host" regulators) to a parent bank's supervisor (the "home" regulator) to ensure that an institution is properly capitalised and well run. Strengthening the liquidity regime is an obvious way for host supervisors to assert greater control but it clearly undermines the ideals of the single market.

Banks that operate across borders are already preparing for a more difficult future. Mr Hele says that ING is studying all aspects of its operations to see how it can cope with a more fragmented landscape in which it is harder to move money around and regulatory compliance costs more. One option is to use excess assets to increase liquidity, by internally securitising loans made in one country and moving them to another to back liabilities there.

The threat of financial mercantilism can be overstated. International flows of capital are not about to vanish—corporate bond markets had a bouncy January, for example. And the risks of financial globalisation can also be dismissed too easily. There are clearly good reasons for local regulators to fret if they face heavy exposures to foreign banks (as in central and eastern Europe). But the risk that the recent homeward flow of bank assets will ossify into a less efficient, less flexible cross-border banking system is real and growing.

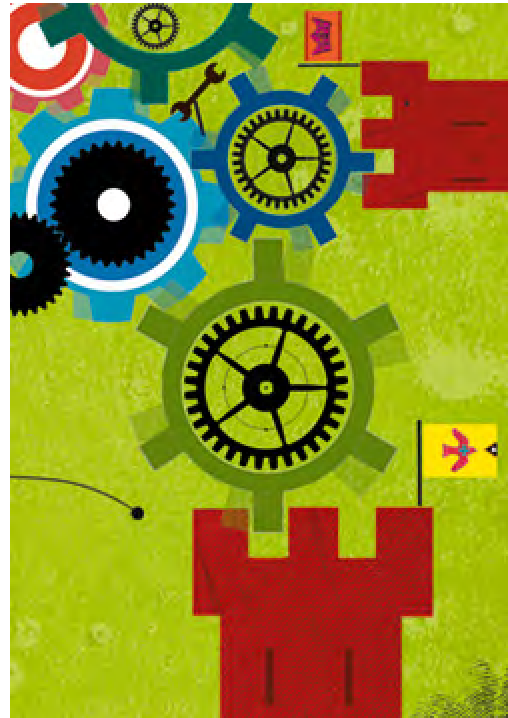
Carmakers

Too many moving parts

Feb 5th 2009
From The Economist print edition

Politicians are desperate to support domestic car industries—but these days there's no such thing

Frazer Hudson



IN A recent report to the World Trade Organisation's (WTO) 153 member states, Pascal Lamy, the club's director-general, sounded a warning about state aid intended to mitigate the economic crisis. It must not, said Mr Lamy, break WTO rules or discriminate against foreign companies. Not surprisingly, he is worried that help for banks could distort competition. But he pointed to another industry too: carmaking. Although he chose his words carefully—many measures are still sketchy—Mr Lamy believes that rich countries' support for their car industries could discriminate against rivals in developing countries.

He is right about one thing. The list of countries offering or planning relief for their automotive industries is long and growing. The reason is not hard to find. Stricken carmakers do not rank with stricken banks as systemic threats; but restoring them to health is still regarded as vital by almost every big, advanced economy. The industry nurtures skills in design and technology that rub off on other sectors; and its supply chain is so long that in some countries about one job in ten depends on it.

What began in America last autumn has spilled over to almost every other leading car-producing country. European policymakers' first response to the bail-out considered by Congress for Chrysler, Ford and General Motors (GM) was hostile. In November the president of the European Commission, José Manuel Barroso, said the commission might file a complaint with the WTO if the plan breached the trade body's rules. Little has been heard from Mr Barroso on the subject since.

His reluctance is partly explained by the similar (if smaller) plans since hatched across the European Union. But it is based too on the knowledge that a collapse of Ford and GM in America would have an incalculable impact on their international operations, many of which are in Europe. Late last year, the fear that GM might enter bankruptcy prompted the German government to start talks with Opel, GM's continental European subsidiary, to try to shield it from the consequences.

The bail-out for Chrysler and GM (Ford still hopes to struggle through on its own resources) at $17.4 billion (and counting) dwarfs anything elsewhere, but that is mainly because among the world's volume carmakers GM is still very big and Chrysler uniquely feeble. If anything, other countries have reacted faster than America, and with less political controversy.

One measure that is gaining in popularity is incentives to trade in older cars for new or nearly new ones. France already has such a scheme; Germany has put money aside for a similar one. Both countries are willing to go further. Peer Steinbrück, Germany's finance minister, has said it would be "fatal" not to support German carmakers when competitors in America were receiving billions of dollars. He was echoing France's prime minister, François Fillon, who said last month that the industry could expect loans and loan guarantees worth €6 billion ($7.8 billion)—if the money was used to keep French factories open.

The Swedish government, desperate to throw a lifeline to Volvo and Saab (Ford and GM, their respective owners, have put both up for sale) has come up with SKr28 billion ($3.4 billion) in loan guarantees and support for research and development. Some of this will come from a €6 billion pot at the European Investment Bank (EIB) to help carmakers meet environmental targets. Fiat is seeking, and likely to get, similar help from the Italian government.

Britain, where the car industry is almost entirely in foreign hands, is tapping the EIB for a £2.3 billion ($3.3 billion) loan and providing credit guarantees worth a further £1.3 billion. The British government's main concern is the survival of Jaguar Land Rover, which India's Tata Motors bought from Ford last year for $2.4 billion.

This is not a game for developed countries alone. The Brazilian government has instructed the state-run Banco do Brasil to make $1.7 billion available to carmakers' financing units. It is also cutting car-purchase taxes. Russia has slapped heavy duties on imported cars for the next nine months and promised 83 billion roubles ($2.3 billion) in direct help to domestic makers, including assemblers of foreign-branded vehicles. China has halved the sales tax on cars with engines of less than 1.6 litres and offered subsidies for trade-ins of high-emission vehicles for cleaner ones. Both measures are aimed chiefly, but not exclusively, at local firms, which make mainly smaller cars.

Two other big Asian car producers, Japan and South Korea, are not joining in yet. The South Korean government seems to be more intent for now on bailing out its shipping and building industries. Japanese carmakers, which depend heavily on exports, are more concerned with heading off protectionism abroad than with seeking direct help from their government. That said, struggling Mitsubishi has asked for assistance in paying workers on short time, as has Mazda. Nissan will soon follow.

How much of all this should properly be regarded as beggar-thy-neighbour protectionism? The car industry has become so globally integrated that it is extremely difficult for governments to help "domestic" industries in isolation, whatever their intent. Should GM and Ford fail in America, attempts to ring-fence their overseas operations might well not succeed. The fate of parts suppliers from Mexico to China would be just as uncertain. Even the Asian "transplants" with which the Detroit firms compete in North America would suffer if much of their shared supply chain went under.

Similarly, when China or Russia helps its car industry, it is also helping all the foreign makers that have built local factories and supply chains. It makes less and less sense to talk about a car's nationality. The Jeep Patriot is only 66% American; a BMW X5 made in South Carolina is a good deal more American than a Pontiac G8 shipped by GM from Australia. Fiat and VW factories in Brazil produce cars that account for half the country's market.

That does not mean the car industry merits special help. There is far too much capacity worldwide and a smaller industry may well eventually be a healthier one. Given the scale of the crisis, only America's bail-out package is of a size to make much difference anyway. Morgan Stanley forecasts that the amount of cash in European makers' manufacturing operations will decline by €34 billion this year. The car business is so big and so global that it is likely to thwart the intentions of even the most protectionist politician.



FINANCE & ECONOMICS

Mortgage losses

Move over, subprime

Feb 5th 2009 | NEW YORK
From The Economist print edition

Decay is spreading to the upper floors of America's mortgage market

Reuters



THE days when subprime mortgages were what kept bankers awake at night are long gone—though thanks only to the barrage of explosions in other corners of finance. In terms of toxicity, however, subprime has had no equal. Until now, perhaps. Even as credit markets, particularly corporate-debt markets, show some signs of improvement, mortgage loans to supposedly better-heeled Americans are souring at a gut-wrenching rate.

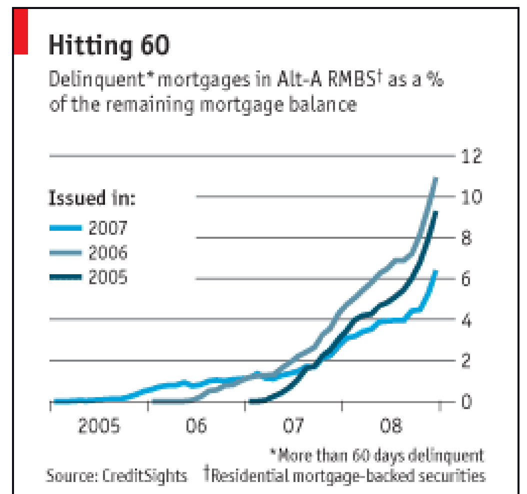
Of particular concern are "Alt-A" mortgages, offered to borrowers sandwiched between subprime and prime. This market was trumpeted as a means of extending home ownership to those, such as the self-employed, with a reasonable credit standing but unsteady income. Its practitioners specialised in loans with scant documentation and exotica such as negative-amortisation mortgages, which allow borrowers to pay less than the accrued interest, with the difference added to the loan balance.

That Alt-A has troubles comes as no surprise. Last summer, for instance, it helped to bring down IndyMac, a Californian bank. But the speed with which loans have soured in recent months, and the reaction of rating agencies, have been startling. Delinquencies rocketed in the final months of 2008. They even rose sharply for loans made in 2005, before underwriting turned really sloppy (see chart).

The rating agencies are rushing to catch up with this grim reality. Moody's, which last summer had issued a sanguine outlook for Alt-A, recently quadrupled its loss projections on bonds backed by such loans. A steady flow of downgrades has turned into a flood in recent weeks, with thousands of Alt-A tranches taking the plunge. The falls have been unusually steep: of the $59 billion of AAA-rated securities that Moody's cut between January 29th and February 2nd, an astonishing 91% went straight to junk, according to Laurie Goodman of Amherst Securities. In ratings terms, Alt-A is doing worse than subprime.

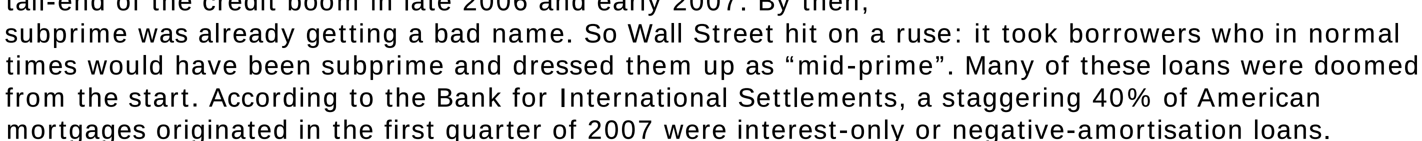
Moody's calls this "unprecedented". That is putting it mildly. It now expects losses for 2006-07 Alt-A securitisations to top 20%, compared with an historical average of well under 1%. In an ugly echo of the fiasco over collateralised-debt obligations, holders

lower down the structure can expect total write-offs, while the vast majority of senior holders will not be spared substantial losses.



The sums involved are depressingly large. In the worst case, losses on the $600 billion of securitised Alt-A debt outstanding—roughly the same as the stock of subprime securities—could reach $150 billion, reckons David Watts of CreditSights, a research firm. Analysts at Goldman Sachs put possible write-downs on the $1.3 trillion of total Alt-A debt—including both securitised and unsecuritised loans—at $600 billion, almost as much as expected subprime losses. Add in option ARMs, a particularly virulent type of adjustable-rate loan, many of which are essentially the same as Alt-A, and the potential hit climbs towards $1 trillion.

Part of the problem is that much of the Alt-A lending came at the tail-end of the credit boom in late 2006 and early 2007. By then, subprime was already getting a bad name. So Wall Street hit on a ruse: it took borrowers who in normal times would have been subprime and dressed them up as “mid-prime”. Many of these loans were doomed from the start. According to the Bank for International Settlements, a staggering 40% of American mortgages originated in the first quarter of 2007 were interest-only or negative-amortisation loans.



In theory, interest-rate declines over the past year should offset the “payment shock” felt by borrowers whose loans reset from low teaser rates to higher ones. But house prices have fallen so steeply that perhaps half of all Alt-A borrowers are in negative equity; for many, walking away may seem the best option. Moreover, option-ARM borrowers who had not expected to start repaying principal until 2015 or later may now have to do so as early as this year, because they are hitting triggers that recast the loan early. Government efforts to stem foreclosures should help these unfortunates, though they may do little for owners of mortgage-backed bonds, who could face higher losses as a result of “cramdowns”, in which bankruptcy courts order a reduction in the principal owed.



Alt-Aaaaaargh

The pain will be felt across the financial industry. Insurance firms, which gobbled up large but unknown quantities of highly rated Alt-A paper, will now be forced sellers since they are not permitted to hold securities rated below investment grade.

Banks have already sold a sizeable chunk of their Alt-A holdings to hedge funds and other asset-management firms, often at large discounts. UBS’s exposure has fallen from $26.6 billion to just $2.3 billion, for instance. But other European banks were not so zealous. ING, a Dutch bank, still has €27.7 billion ($35.1 billion) of Alt-A debt. American banks are sitting on perhaps $800 billion of the stuff.

As the market prices of mortgage securities have fallen, banks have had to mark down their holdings, taking “unrealised” losses that erode their capital position. Multi-notch downgrades could put further downward pressure on prices. They hit capital in another way, too, because junk-rated debt carries a punitive risk weighting; banks must set aside five times as much capital as they have to for top-notch securities. Rating cuts also affect income statements, by pushing banks to acknowledge that losses which they had classified as temporary are now permanent.

The weakest may now need to raise fresh equity. If they are lucky, banks will be able to palm some of the risk on to governments via asset guarantees or “bad banks” that assume their noxious assets. The Dutch government has agreed to bear the risk on much of ING’s Alt-A holdings, and Citigroup’s $11.4 billion exposure to Alt-A bonds falls under a guarantee that formed part of its November bail-out. It will receive further help from the industry-wide bank-rescue package that the Obama administration is preparing.

What the taxpayer will get in return is far from clear. Officials are still wrestling with how to value beaten-up mortgages. Assessing the worth of Alt-A loans can be especially tricky because they are maddeningly heterogeneous, thanks to a broad assortment of payment options. Less rigorous banks carry some holdings at around 60 cents on the dollar. Morgan Stanley’s are marked at half that. Its shares have rebounded recently, partly on hopes that it will be able to write up these securities once the government unveils its bail-out.

The biggest single Alt-A casualties are America’s bungling mortgage agencies, Fannie Mae and Freddie

Mac. They waded into the market in 2006-07, snaffling up business in red-hot states such as California and Arizona, comforted by down-payments of 20%. When house prices there fell by more than that, they were left holding the first loss, since borrowers who put in that much equity do not have to take out mortgage insurance.

Rotten as Alt-A loans are, worse may be to come. As unemployment in America heads towards 8%, even strongly underwritten loans will go bad. Bankers are growing increasingly anxious about the $1.1 trillion of prime mortgage loans and securities, much of which they held on to themselves, assuming it to be bombproof. This sits on their books at “much more optimistic” values than lower-grade mortgages, says one. Some 70% of prime securities will eventually have their ratings cut, according to a “downgrade-o-meter” produced by JPMorgan Chase. As Guy Cecala of *Inside Mortgage Finance*, a newsletter, puts it: “The mortgage storm’s first wave was subprime. Now we are being buffeted by Alt-A. But a bigger wave is on the horizon, and it cuts across all loan types.”

Russia's currency

Down in the dumps

Feb 5th 2009
From The Economist print edition

The rouble, a symbol of the Kremlin's power, is looking sickly

AP

Keeping her head down

AT DAVOS Vladimir Putin, Russia's prime minister, was oozing confidence. He had a go at America and insisted that Russia was coping admirably with the crisis, thanks to its large reserves. "We don't need help. We are not invalids," Mr Putin said in a withering answer to an offer of technology from Michael Dell, a computer tycoon.

On the face of it, Russia seems stable: there are no queues outside the banks. But behind this tranquillity lies an alarming reality. Growth has stopped, the rouble has lost more than a third of its value since August and inflation is running at around 13% a year. Oil prices have slumped and international currency reserves have fallen by more than $200 billion in six months to $388 billion. On February 4th Fitch, a rating agency, downgraded Russia by one notch.

Yet, for all the brave talk, there is a self-destructive streak in Russia which can turn a drama into a crisis in spectacular fashion—as was vividly demonstrated during its 1998 default. This time Russia has more reserves, but it is making the same mistakes, says Evgeny Gavrilenkov, an economist at Troika Dialog, a Moscow bank.

The most immediate concern is the currency. Instead of allowing a big devaluation in a single go, which would have been politically painful but economically productive, the government has let the rouble slide gradually. This has allowed people to adjust to the devaluation, but it has also stymied growth, Mr Gavrilenkov argues.

As the currency inched lower, the central bank injected rouble liquidity into a select group of banks allowing them to speculate on the currency market instead of lending money into the real economy. It has been lending between $10 billion- and $20 billion-worth of roubles a day through overnight repo operations at a monthly interest rate of less than 1%. As a result, Mr Gavrilenkov says, the beneficiaries could make a profit margin of nearly 70% on currency bets. In 1998, the government guaranteed almost the same rate of return through short-term debt obligations.

As oil prices fall, the rouble will naturally weaken, but the authorities are anxious to stop it. Capital controls, which Russia used to have before it decided to liberalise its capital account in 2006, are both economically and politically unpalatable; the convertibility of the rouble was hailed as a triumph for Mr Putin.

Another response is to put up interest rates—at least above inflation. Although in theory this could further slow economic activity, Rory MacFarquhar of Goldman Sachs argues that, since banks are not passing on the cheap central-bank funding to firms anyway, raising the central-bank rate would not make much difference to growth. "At least the banks would not be holding the whole country hostage."

The central bank has now indicated that it might tighten monetary policy, yet it still wants to defend the rouble. On January 22nd it promised that the rouble would not fall below 41 to a euro/dollar basket of currencies. Less than two weeks later, it had almost hit that floor. Letting it drop further might prompt a massive onslaught.

But the currency is not the only problem. The banking system, which has more than 1,000 banks, needs cleaning up. Peter Aven, the head of Alfa Bank, estimates that between 10-20% of all loans could be in default by the end of the year. On February 4th the government said it would increase the capital of the top 50 banks which hold 80% of all assets by 15% if the private owners do the same.

Sergei Guriev, the head of the New Economic School in Moscow, says three main problems of the Russian banking system are the (still relatively) strong rouble, poor banking assets and an intolerable level of uncertainty in the government’s actions. None of Russia’s problems is unsolvable, but all require strategy and transparency rather than overconfident rhetoric.

Japan's currency

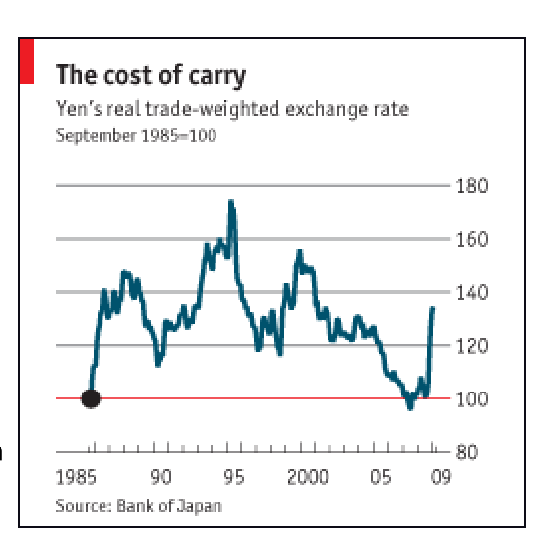
Up and away

Feb 5th 2009 | TOKYO
From The Economist print edition

Suddenly, talk is back of intervention to stem the yen's rise

SINCE the summer, the yen has shot up against all major currencies. It is now 23.2% higher than last year's low-point against the dollar, 46.7% higher against the euro, and 65% up against the tumbling pound. Manufacturers are screaming. Japanese exports are down by over a third compared with a year ago, and carmakers and electronics firms are slashing production and jobs. On February 2nd the *Keidanren*, a big-business club, declared the value of the yen, at under ¥90 to the dollar, to be manufacturers' most critical problem. They were, it said, "crying out" for the government to weaken the yen, either alone or in league with other countries.

They may cry in vain. In trade-weighted terms the currency is not overvalued by historical standards (see chart). A long undervaluation has merely corrected itself. The exporters driving Japan's recovery from 2002-07 made two false assumptions as they built new capacity: that American consumers would always buy Asian exports, and that ¥100-120 to the dollar was the sustainable long-term rate. Both were chimeras.



The yen's undervaluation was what Eisuke Sakakibara, a former vice-minister of finance, calls a "cheap-yen bubble". Exceptionally low global financial-market volatility in the middle of the decade helped spur the famous yen carry trade. Foreign banks and hedge funds borrowed yen at low interest rates which they then sold, swapping the yen into higher-yielding currencies and profiting from the yield difference. Japanese retail investors followed a similar ploy, buying quantities of foreign-currency bonds for their higher yield. Some of what they bought were structured products sold by banks that protected investors against currency losses.

Since the summer, foreigners have unwound the yen carry trade with a vengeance, driving the yen up. Not only are retail investors (and writers of structured products) sitting on capital losses; overseas yields have also plummeted. Households' holdings of overseas securities, says Tohru Sasaki of JPMorgan Chase, remain huge—¥13.9 trillion at the end of September, the latest figures available, double the amount of a year earlier. He says that with unemployment set to jump and the economy set to shrink by, say, 5.7% this year, households will bring yen home. Mr Sakakibara predicts that a climb to ¥85 against the dollar will trigger a wave of stop-loss orders, sending the exchange rate quickly to ¥80 or even ¥75. The government would then face huge pressure to intervene for the first time since March 2004.

It will not want to dive in alone. In government a decade ago, Mr Sakakibara moved markets with his utterances. But in 1995-96, he points out, American and Japanese interests were perfectly aligned. This time, the support of Timothy Geithner, America's new treasury secretary, is not assured. None of the industrial countries is keen to risk a round of competitive devaluations. Japan's finance ministry may, some believe, have pulled out its swimsuit, but it remains reluctant to take the plunge.

American Treasury bonds

Too much of a good thing

Feb 5th 2009 | WASHINGTON, DC
From The Economist print edition

A wave of new borrowing threatens a port in a storm

IN THE trouble-tossed world of finance, the one safe place during the credit crisis has been America's vast and liquid Treasury-bond market. No longer. Since touching a record low of 2.04% in mid-December, ten-year bond yields shot up above 2.9% on February 4th, continuing a sell-off that made January the worst month for government securities in decades.

There are several reasons for the reversal of fortunes, not all of them bad. Yields tumbled last year partly because panicked investors jettisoned every other sort of fixed-income security, such as asset-backed bonds, corporate bonds, even the Treasury's inflation-protected bonds, known as TIPS. Some tentative signs of healing in the credit markets suggest the panic has ebbed, and spreads between Treasury yields and more risky bonds have narrowed.

Another big factor appeared to be the threat of deflation that loomed over America's economy as consumer prices slipped. Any sign this is weighing less on investors' minds would be welcome. When bond yields hit their lowest, the spread between yields on nominal Treasuries and TIPS implied that the market was factoring in deflation of 5.5% in 2009 and zero average inflation for the next decade, according to Michael Pond of Barclays Capital.

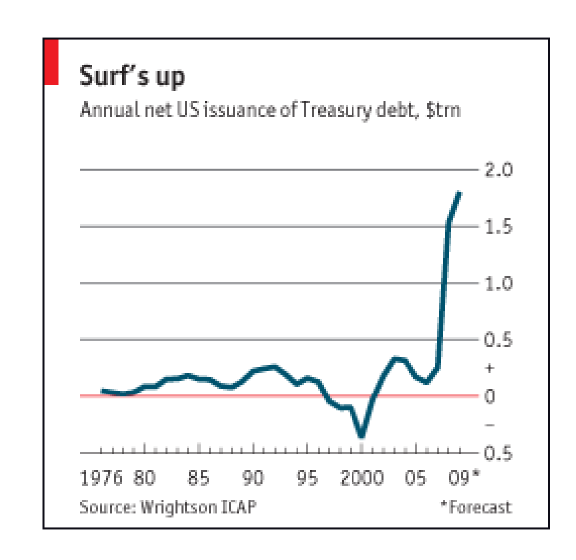
But the fear of deflation may not have been the overriding concern, Mr Pond argues. More important, he says, investors deserted relatively illiquid TIPS in favour of nominal bonds, driving the yields in opposite directions. The same spread now implies, implausibly, deflation of 2.5% this year, and zero inflation until 2014, before reaching 2-3.5% thereafter. In that case, nominal yields could rise quite a bit more relative to TIPS yields without signalling an inflation scare.

As in all markets, supply and demand have played a big role. Yields were driven down in December after the Federal Reserve declared that it was considering purchases of long-term Treasury and mortgage debt in order to lower long-term interest rates (it later reduced short-term rates virtually to zero). It went ahead with the purchases of mortgage debt. But at its last meeting on January 27th, it merely retained the option to buy Treasury bonds. That disappointed investors.

The biggest force behind the bond-market shock is the onslaught of new issuance as the government seeks to finance the gaping budget deficit, Fed liquidity programmes, mortgage purchases and bank bail-outs. Yields moved still higher this week partly on the Treasury's announcement that it would borrow a whopping $493 billion this quarter. Wrightson ICAP, a research firm, predicts the Treasury will issue $1.8 trillion this year, which combined with $1.5 trillion last year, would exceed all the net borrowing of the prior 27 years combined (see chart).

Meanwhile, the Treasury is facing growing competition for funds in the corporate-bond market, which has seen some unusual levels of activity since the start of the year. Excluding debt backed by the government, the total reached $76 billion, not far short of the previous record for a January, $82 billion in 2001.

The revival of corporate-bond markets, if sustained, would be good news. Moreover, there is still sturdy demand for Treasuries from abroad; foreigners refused to dump them even when they lost confidence in mortgage-backed debt last year. But America cannot take things for granted. If private credit continues to revive and there is no sign budget deficits are coming down, investors may worry that America will attempt to inflate its debts away. Then the storm really will hit Treasuries.


Surf's up
Annual net US issuance of Treasury debt, $trn
2.0
1.5
1.0
0.5
+
0
-
0.5
1976 80 85 90 95 2000 05 09*
Source: Wrightson ICAP
*Forecast

Asian stockmarkets

Bye bye sell

Feb 5th 2009 | HONG KONG AND SEOUL
From The Economist print edition

Tired of bad news about the financial markets? Censor it

Illustration by S. Kambayashi



NOT so many years ago brokers were prosecuted in America for shamelessly plugging the dogs of the dotcom boom. Consider it a sign of the times that governments in South Korea and Taiwan are now quietly encouraging brokers to accentuate only the positive.

The methods may differ, but if you have something critical to say and it somehow becomes public knowledge, you should brace yourself for unpleasant consequences. In December the Taiwan Securities Association, a trade body, reminded brokers, on behalf of the government, that the press must receive the firm’s approval before quoting research.

When critical brokers’ opinions are cited in newspapers, regulators now want “explanations”. On February 4th CLSA, a regional broker, issued a report saying Taiwan’s economy had deteriorated sharply. The press jumped on the report, and the government jumped on CLSA, which quickly issued a statement. The report was intended for clients alone and CLSA had not changed its investment opinions. Regulators have insidiously suggested that investment firms take a harder line by suing media outlets that report on their opinions.

In South Korea, a reluctance to issue sell recommendations has already taken hold. Of the 17,335 reports issued by South Korean brokers in 2008, there were 14,903 “buy” recommendations but not a single “sell”, according to FnGuide, a Seoul-based financial-information company. At best, that reflects poor analysis: the stockmarket tumbled 41% during the year.

But something more sinister may be afoot. JPMorgan, an American investment bank, was the target of an investigation by the Financial Supervisory Service after it suggested that problem loans at South Korea’s Hana Bank may be higher than the bank’s own estimates. Switzerland’s Credit Suisse was denounced by Hyundai Securities, which publicly castigated the firm after it halved its target price for the South Korean broker. One analyst recalls a threatening telephone call from a sushi-restaurant owner after he issued a “sell” recommendation: “I have many sharp knives. Stay away from dark alleys,” the man said.

Fortis

What a carve-up

Feb 5th 2009
From The Economist print edition

Will a renegotiated deal seal BNP's messy purchase of a Belgian bank?

AT FIRST the dismemberment of Fortis, a failed Belgo-Dutch lender, seemed to go rather well. In September the governments of Belgium, the Netherlands and Luxembourg all injected capital to stabilise the bank. The Dutch then nationalised their bits of the bank and the Belgians (and Luxembourgeois) agreed to sell France's BNP Paribas the businesses that Fortis had on their soil. A violent end, it appeared, but a swift one. Ha! One fallen government, one renegotiated deal and weeks of wrangling later, BNP still awaits confirmation of the transaction. Even a vote by Fortis shareholders in Brussels on February 11th may not end the saga.

The problems began when a Belgian appeal-court ruling froze the BNP sale and ordered that shareholders be given a proper say in the break-up of the bank. Alleged attempts by officials to influence that ruling caused the Belgian government to fall in December.

BNP and the new Belgian government have now tried to sweeten the deal for enraged Fortis shareholders, who have seen their bank go from a successful predator in the battle to acquire ABN AMRO, a big Dutch bank, to a financial carcass. On January 30th the two announced several amendments to the sale agreement. As before, BNP will take a 75% stake in Fortis's Belgian bank, but instead of swallowing all of its Belgian insurance arm as well, it will take only 10% of that business. BNP and the Belgian government will also take a bigger slice of a fund housing the worst of Fortis's structured assets.

The renegotiated deal has something for everyone. The rump of Fortis has a more promising independent future. Losing the insurance business is a minor blow for BNP: the banking franchise is what really matters. And the Belgian government gets rid of one of its financial headaches.

That still may not be enough to win the day. Ping An, a Chinese insurer that is Fortis's biggest investor, is reportedly planning to say "no" to the deal. And the terms of the vote on February 11th are confusing, to say the least. According to the circular sent out to shareholders, a "no" vote means not that a deal with BNP is off, but that the original agreement with the French bank is reinstated. So a shareholder who rejects the new deal because he wants better terms ends up voting for an old deal that offers worse terms. Whatever happens, more legal challenges loom.

Corporate finance

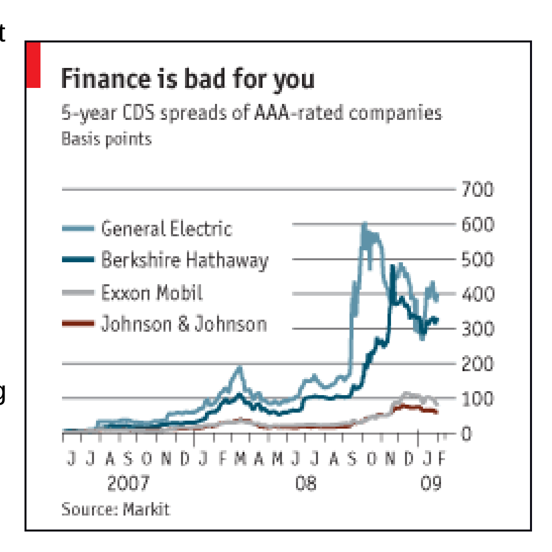
Triple trouble

Feb 5th 2009
From The Economist print edition

Are AAA ratings bad for firms' health?

JUST as straight-A students have been drawn to exotic areas of finance over recent decades, so have several firms with AAA credit ratings. General Electric (GE) relentlessly expanded its finance arm which handles everything from credit cards to property. American International Group (AIG) diversified from plain insurance into credit derivatives. And even Warren Buffett's Berkshire Hathaway was tempted to write a book of equity-derivative contracts that has recently created a big mark-to-market liability in its accounts.

Just as plenty of AAA banks have been taken to the cleaners, so these non-bank firms have suffered too. AIG is now state-controlled, after huge derivative losses. Standard & Poor's (S&P) says GE now faces a one-in-three chance of losing its rating, which it has held since 1956, largely due to problems at its financial arm. Berkshire Hathaway's credit-default swap spreads are far above those of AAA non-bank firms, such as Exxon Mobil (see chart).



Rock-bottom borrowing costs undoubtedly created moral hazard at banks. Might AAA ratings have also tempted non-banks to take foolish risks? Not in general. The number of industrial firms with S&P's highest credit score has dropped from over 60 in the 1980s to just six today, but this largely reflects shareholder pressure on firms to gear-up core businesses, or a dimming of their industry's prospects.

A few firms do seem to have sought exposure to finance precisely because they wanted to exploit their high ratings, however. "My gut told me that…this business seemed an easy way to make money," wrote Jack Welch, GE's former boss. It was about "finding smart and creative people and then using GE's strong balance-sheet." When AIG set up its credit-derivatives arm in the 1980s it hired specialists from the junk-bond shop Drexel Burnham Lambert, who were attracted partly by the potential to piggyback off AIG's excellent rating.

Such instincts are not always wrong. Risky activities can create losses and should eventually raise a firm's overall cost of borrowing—but that is acceptable if the profits compensate.

Ajit Jain, an executive at Berkshire Hathaway, has said that with its AAA rating the firm has toyed with entering the bond-insurance market for the past 20 years. Only recently, after the collapse of the industry, have prices risen to a level that Berkshire finds attractive.

Even if the prices are right, depending on being AAA-rated for survival is a treacherous strategy. This has little to do with the small rise in borrowing costs a lower rating might prompt; the real danger is from the collateral calls that counterparties can demand. Like some banks, AIG found that downgrades fed a fatal liquidity crisis. Reassuringly, Berkshire Hathaway says most of its equity derivatives do not require collateral postings. GE, meanwhile, insists that a downgrade would have no "major" impact. Although an AAA rating is nice and exploiting it can make sense, nobody should become its slave.

The IMF

Supersizing the fund

Feb 5th 2009
From The Economist print edition

The IMF needs more than just money if it is to tackle global imbalances

Illustration by S. Kambayashi



DOUBLING the lending capacity of the IMF to $500 billion might seem like a bold idea. But when John Lipsky, the fund's deputy head, announced its intention to do just that on January 31st, India's chief economic planner, Montek Singh Ahluwalia, deemed the proposal too modest. Instead, he suggested tripling its members' IMF quotas, or the capital they provide.

To hear developing countries call for a bigger role for the IMF would have sounded, just a short while ago, as if they were asking for a bigger rod for their backs. The fund, after all, is hardly popular. But given the tumultuous state of global capital flows, it is not entirely surprising.



As the crisis has spread, the massive influx of capital to developing countries, which had made the IMF seem so irrelevant during the boom, has slumped. The Institute for International Finance, a group of senior bankers, reckons that net inflows into emerging markets, which were $929 billion in 2007, will fall to $165 billion in 2009. Trevor Manuel, South Africa's finance minister, spoke of fears of “decoupling, derailment, and abandonment”—the prospect of being shut out of international capital markets as Western banks, in particular, withdraw from foreign markets.

All of which has given emerging economies a renewed appreciation for multilateral financing, and a sense that the IMF's resources may need beefing up. Arvind Subramanian, a former IMF economist now at the Peterson Institute for International Economics in Washington, DC, reckons it may need up to $1 trillion. But even supersizing the fund may not be enough.

There are those who think the fund's mission should go beyond doling out money to helping prevent the build-up of global financial imbalances that led to this crisis. Part of that lopsidedness was the huge pile of international reserves emerging countries built up during the boom on the back of strong exports. The flip side was the rising deficits of consumer countries in the developed world.

But some people, such as Mr Ahluwalia, argue that the build-up of those reserves stemmed partly from the IMF's shortcomings. They were amassed because the developing countries did not believe that the IMF was adequately equipped to provide financing when it was needed. Indeed, the fund recognises that countries are loth to turn to it even when it has enough money to lend, which suggests that more money, by itself, may not be enough to make it more effective.

Raghuram Rajan, a former IMF chief economist, says a big part of the solution might be to give emerging nations more say in the IMF, which is dominated by Europe and America. Discussing reforms to the IMF's governance is on the agenda when the leaders of the Group of 20 meet in London on April 2nd, and the fund has set up a committee headed by Mr Manuel to look into the matter. The big powers will be reluctant to give ground, not least because they are the fund's main backers. But if they do not, the risk is that the developing world will be tempted to build even larger piles of reserves to insure itself against future crises.

Economics focus

Burger-thy-neighbour policies

Feb 5th 2009
From The Economist print edition

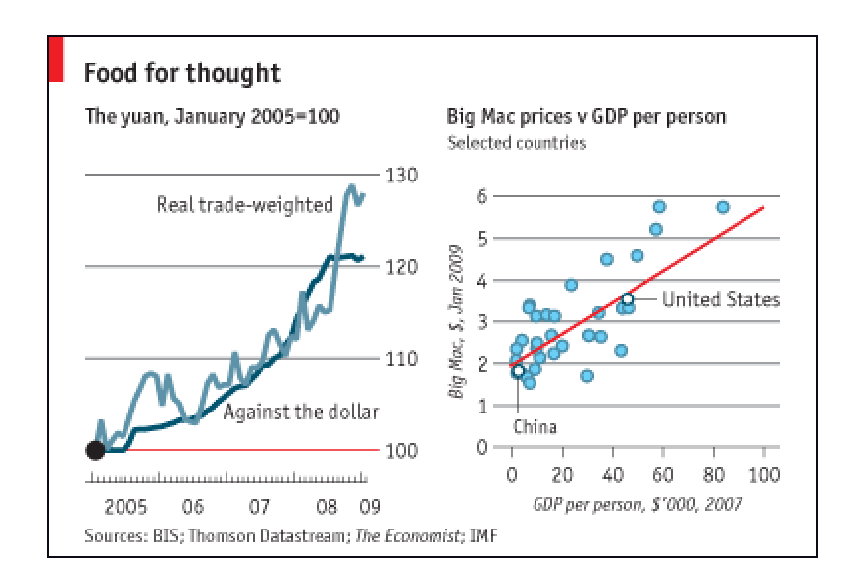
Attacks on China's cheap currency are overdone

CHINA has been accused of "manipulating" its currency by Tim Geithner, America's new treasury secretary, and this week Dominique Strauss-Kahn, the managing director of the IMF, said that it was "common knowledge" that the yuan was undervalued. You would assume that such strong claims were backed by solid proof, but the evidence is, in fact, mixed.

Of course China manipulates its exchange rate—in the sense that the level of the yuan is not set by the market, but influenced by foreign-exchange intervention. The real issue is whether Beijing is deliberately keeping the yuan cheap to give exporters an unfair advantage. From July 2005, when it abandoned its fixed peg to the dollar, Beijing allowed the yuan to rise steadily, but since last July it has again been virtually pegged to the greenback. And there are concerns that China may allow the yuan to depreciate to help its exporters—with worrying echoes of the beggar-thy-neighbour policies that exacerbated the Depression. But American politicians are wrong to focus only on the yuan's dollar exchange rate. Since July the yuan has gained 10% in trade-weighted terms. It is up 23% against the euro, and 30% or more against the currencies of many other emerging economies.

In early 2005 two American senators brought a bill to Congress that threatened a tariff of 27.5% on all Chinese imports unless the yuan was revalued by that amount. This curiously precise figure was the midpoint of a range of estimates (15-40%) of the yuan's undervaluation. The bill was dropped, but the yuan has since risen by that magic amount in real trade-weighted terms (see left-hand chart, below). So how much further should it rise?

Those who argue that the yuan is still too cheap point to three factors: China's foreign-exchange reserves have surged; it has a huge current-account surplus; and prices are much cheaper in China than in America. Start with official reserves. If China had not bought lots of dollars over the past few years, the yuan's exchange rate would have risen by more. So does the yuan's fixed level against the dollar in recent months mean that intervention has risen? On the contrary, in the fourth quarter of 2008, China's reserves barely rose, despite a record current-account surplus. This suggests that private capital is now flowing out of China.



Charles Dumas, an economist at Lombard Street Research, argues that outflows of hot money could become a flood if China did not have capital controls. Currency "manipulation" amounts to more than foreign-exchange intervention; China also has strict capital controls which, although leaky, keep private savings at home. If Beijing scrapped those controls, firms and households would want to invest abroad to

diversify their assets. In other words, if the value of the yuan was not "manipulated" and instead was set entirely by the free market, it might fall, not rise.

Some argue that China's large current-account surplus is incontrovertible proof that the yuan is too cheap. Morris Goldstein and Nicholas Lardy, at the Peterson Institute for International Economics in Washington, DC, estimate that the yuan's real trade-weighted value needs to rise by another 10-20% to eliminate the surplus. But other economists say it is wrong to define the yuan's fair value by the revaluation required to eliminate the current-account surplus. Trade does not have to be perfectly balanced to be fair. And China's surplus partly reflects its high saving rate. A stronger yuan will help to shift growth away from exports towards domestic consumption, but is unlikely to do so on its own. In 2005 Messrs Goldstein and Lardy reckoned that the yuan was 20-25% undervalued; it has since risen by that, yet the surplus has doubled. To reduce China's external gap, policies to boost domestic spending will be more important than its exchange rate.

Beefing up the argument

An alternative way of defining the "fair" value of a currency is purchasing-power parity (PPP): the idea that, in the long run, exchange rates should equalise prices across countries. *The Economist*'s Big Mac index offers a crude estimate of how far exchange rates are from PPP. Our January update found that a Big Mac cost 48% less in China than in America, which might suggest that the yuan is 48% undervalued against the dollar. But by this gauge, the currencies of virtually all low-income countries are undervalued, since prices are generally lower in these countries than in rich ones (see right-hand chart, above). This is the basis of the Balassa-Samuelson theory which holds that average prices will be higher in countries with higher productivity (ie, high GDP per head), because higher wages will push up prices in labour-intensive goods and services. This implies that it is natural for China's exchange rate to be below its PPP, but as it gets richer and productivity rises, its real exchange rate should rise.

PPP is a long-term concept. However, the relationship between prices and GDP per head can be used to estimate the short-term fair value of a currency relative to others. Using a simple model, which adjusts the Big Mac index for differences in countries' GDP per head and relative labour costs, gives the result that the yuan is now less than 5% undervalued.

A new study* by Yin-Wong Cheung, Menzie Chinn and Eiji Fujii arrives at a similar result using World Bank price data across the whole economy. Previous assessments of such data had found that the yuan was around 40% undervalued. But the latest price surveys have raised the estimated price level in China (and so reduced GDP per head measured at PPP). The authors conclude that the yuan was 10% undervalued against the dollar in 2006, which means that it might now be close to parity.

The evidence that the yuan is significantly undervalued is hardly rock-solid. It probably is still a bit too cheap, and it would certainly be a mistake for Beijing to allow it to fall, not least because this would risk a protectionist backlash from abroad. In the longer term, the yuan needs to keep rising against a basket of currencies. But for now, some of the accusations being thrown at China are wide of the mark.

---

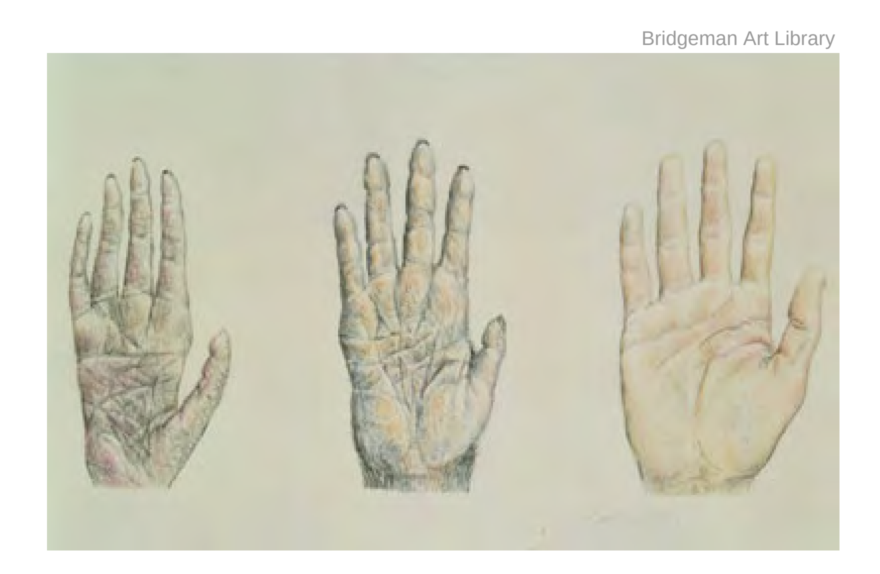
*"China's current account and exchange rate". NBER working paper 14673.

Evolution

Unfinished business

Feb 5th 2009
From The Economist print edition

Bridgeman Art Library



Charles Darwin's ideas have spread widely, but his revolution is not yet complete

THE miracles of nature are everywhere: on landing, a beetle folds its wings like an origami master; a lotus leaf sheds muddy water as if it were quicksilver; a spider spins a web to entrap her prey, but somehow evades entrapment herself. Since the beginning of time, people who have thought about such things have seen these marvels as examples of the wisdom of God; even as evidence for his existence. But 200 years ago, on February 12th 1809, a man was born who would challenge all that. The book that issued the challenge, published half a century later, in 1859, offered a radical new view of the living world and, most radical of all, of humanity's origins. The man was Charles Robert Darwin. The book was "On the Origin of Species". And the challenge was the theory of evolution by natural selection.

Since Darwin's birth, the natural world has changed beyond recognition. Then, the modern theory of atoms was scarcely six years old and the Earth was thought to be 6,000. There was no inkling of the size of the universe beyond the Milky Way, and radioactivity, relativity and quantum theory were unimaginable. Yet of all the discoveries of 19th- and early 20th-century science—invisible atoms, infinite space, the inconstancy of time and the mutability of matter—only evolution has failed to find general acceptance outside the scientific world. Few laymen would claim they did not believe Einstein. Yet many seem proud not to believe Darwin. Even for those who do accept his line of thought his ideas often seem as difficult today as they were 150 years ago.

The origin of the Origin

The idea of evolution by natural selection is not hard to grasp. It just requires connecting some uncontentious propositions. These are that organisms vary from one another, even within a species, and that new variation can arise from time to time; that some of this variation is passed from parent to offspring; and that more individuals are born than can exist in the available space (or be sustained by the available resources). The consequence is what Darwin described in his book as a "struggle for existence". The weakest are eliminated in this struggle. The fit survive. The survivors pass on their traits to their offspring. Over enough time, this differential transmission of characters will lead to the formation of a new species.

Darwin was neither the first to recognise these simple ideas nor to put them together. Thinkers as far back as Empedocles, a Greek philosopher born in 490BC, are known to have suggested that natural selection might explain why animals were adapted to their surroundings. The idea of the struggle for existence has been traced as far back as al-Jahiz, a Muslim theologian and scholar born in Basra around

776. And the idea crops up again in the works of Thomas Hobbes, a 17th-century philosopher, and Erasmus Darwin (Charles's grandfather), who lived in the 18th.

By the beginning of the 19th century, the idea of evolution was in the air. There was an emerging acceptance that species were unstable. The botanists could see it in their hybrids. But what was missing was the mechanism.

At the start of the 19th century Jean-Baptiste Lamarck, a French naturalist, thought he had found it. He recognised that species were mutable, and he also proposed that traits could be inherited. His error was to suppose that individuals lost characteristics that they did not need in life and developed ones that they did—and that it was these changes that were passed to their offspring. A giraffe, for example, might grow a longer neck because it was useful for eating food that other giraffes could not reach. Its progeny would then inherit the attribute. It was a nice idea, but Lamarck was wrong. Acquired characteristics cannot be transmitted in this way.

In the end, the answer came not from biology but from economics. In 1798 Thomas Malthus wrote "An Essay on the Principle of Population". Malthus argued that natural populations grow at an exponential rate, whereas the increase in food supply is linear. In other words, more individuals are born than can possibly survive. His book popularised what was, in fact, an old idea, at just the right time for biology. After reading Malthus, both Darwin and Alfred Russell Wallace, a British naturalist, independently put the pieces of the puzzle together and dreamed up evolution by natural selection.

They both saw what Lamarck had failed to, that the struggle for existence in a crowded world, with its winners and losers, was the force that would ensure the survival of the plants and animals carrying the best traits. Darwin's autobiography records his eureka moment: "I happened to read for amusement Malthus on population, and being well prepared to appreciate the struggle for existence…it at once struck me that under these circumstances favourable variations would tend to be preserved, and unfavourable ones to be destroyed. The result of this would be the formation of new species."

The first to see selection

It turns out, though, that even Darwin and Wallace were not the first to put the pieces together. In 1813 William Charles Wells, a Scottish doctor, had presented a paper on race to the Royal Society, in which he introduced the idea of natural selection to explain why people might vary in skin colour in different climates. And in 1831 Patrick Matthew, a Scottish landowner, provided a description of natural selection in an appendix to a book about growing the best trees to make warships.

Nevertheless Darwin and Wallace are remembered, whereas Wells and Matthew are not, because they made the idea explicit and both wrote papers devoted to it. These they presented to the Linnean Society in London in 1858. Darwin, moreover, is more famous than Wallace because he had devoted the previous two decades to the painstaking accumulation of evidence in support of the theory from areas as diverse as embryology, artificial breeding, geography, economics and geology, and so was able to go into print the following year with "On the Origin of Species by Means of Natural Selection, or the Preservation of Favoured Races in the Struggle for Life", to give the book's full title.

Darwin's theory explained why species were so well adapted to their environment and how new species would form. It suggested that all living things were related, from the beetle to the lotus, and that everything descended ultimately from a single common ancestor. Evolution thus removed the need for divine explanations of diversity and, along with evidence emerging at that time of the extreme age of the Earth, it further suggested that the wider universe might also owe nothing to divine intervention and everything to natural laws. Darwin understood all of this and was greatly troubled.

That trouble continues today. In the United States a Gallup poll conducted last year found that only 14% of people agreed with the proposition that "humans developed over millions of years", up from 9% in 1982. Acceptance of evolution varies around the world, with the most ardent believers being in Iceland, Denmark and Sweden (see chart). In general, as you might expect, a country's belief in evolution is inversely correlated with its belief in God. But

there is an interesting twist.

Gregory Paul, an independent researcher on evolution, and Phil Zuckerman, a sociologist at Pitzer College in California, have argued controversially that a belief in God is inversely correlated with the level of what might be described as the intensity of the struggle for existence. In countries where food is plentiful, health care is universal and housing is accessible, people believe less in God than in those countries where their lives are insecure. A belief in God, and rejection of evolution, they suggest, is most valuable in those societies that are most subject to Darwinian pressures.

The fossil record

Public acceptance of evolution*, 2006, %

True / Not sure / False

Iceland, Denmark, Sweden, France, Britain, Norway, Belgium, Spain, Germany, Italy, Netherlands, Hungary, Luxembourg, Ireland, Switzerland, Austria, Greece, United States, Turkey

Source: *New Scientist* — *Selected countries

Making science work

Be that as it may, many aspects of modern science could not work without accepting evolution. Darwin's ideas touch every corner of biology and medicine. They have also had an impact farther afield, in areas from art to politics. And their impact has been practical as well as theoretical. Both software engineers and drug developers, for example, often make use of evolutionary thinking when designing their products.

Economics, too, may be helped by Darwin. Ideas about "rational" economic man are being overturned by new ones from a discipline called behavioural economics. Rather than assuming that individuals faced with economic decisions will comport themselves in what "classical" economists regard as a rational manner—ie, to maximise their future wealth—behavioural economics tries to study how real people actually behave.

What is surprising is the degree to which human beings are not rational, and how the reasons for this are likely to involve Darwinian explanations. Take, for example, a phenomenon called the endowment effect, which is the tendency most people have to value objects they already own more highly than similar ones they have never owned—and, consequently, to be more reluctant to trade them than a classical economist would predict.

Because this effect has been observed in three primate species, most recently in a study of chimpanzees, it suggests this effect has evolutionary roots. Its strength seems to relate to the evolutionary salience of the item in question. People may be reluctant to trade goods related to food and mating because in the recent evolutionary past it meant parting with a known object in exchange for an uncertain proposition.

Another example of economic behaviour that may have deep evolutionary roots is the "herd" mentality that contributes to financial bubbles. In the past, copying the neighbours would have been helpful—in order to avoid danger or to find food. In today's financial systems, however, it can create instability. The instinct to follow the herd can be rationalised as rational, so to speak, since everybody benefits in the short term by forcing the price up. But it does not look so rational when the instability is exposed by an external shock and the market crashes. In fact, at least part of what seems to be going on is that everyone instinctively feels compelled to copy the others, rather than making an independent assessment of the situation.

Whether the mystery is why people are so averse to risk, unable to estimate the time needed for a given task, or give different answers to the same question depending on how it is framed, there is a fair chance that the explanation will, at some point, involve evolution. To understand human behaviour properly, the world needs Darwin. Some have said it is the best idea that anyone ever had. If it isn't, it certainly comes close.

Despite so much evidence, evolution remains difficult to accept because it implies everything living is largely accidental. Stephen Jay Gould, an American evolutionary biologist, who died in 2002, argued that misunderstandings about Darwinism were rife not because the theory is difficult to understand but because people actively avoid trying to understand it. He thought a misunderstanding about progress was the problem.

Completing the revolution

People are comforted by the idea of a designed and harmonious natural world, with themselves at the top. It is hard to accept that such harmony has arisen as an accidental consequence of a brutal system with no principles beside the one that every individual is striving for reproductive success. It is depressing to think that life is purposeless and that evolution has no higher destination.

This criticism applies to many believers in evolution who are not actually workers in the field, as well as those who reject the theory. It is a commonly held view that evolution implies progress, even among those who believe in natural selection.

Most biologists disagree. They argue, along with Gould, that evolution has no fixed direction. A creature can become fitter by getting more complex. But it can also become fitter by getting simpler. It all depends on the circumstances. The undoubted increase in average complexity in the fossil record is, according to this view, an accident of the fact that life started simple and therefore had only one direction to go in. Changes that lead to complexity are more obvious than those that lead to simplicity, since they create something that was not there before. This does not mean, however, that they are more numerous.

Gould's view was thus that the evolution of human intelligence while not exactly an accident, since it was a response to a long series of circumstances, was certainly not a foregone conclusion. If that series of circumstances had been even slightly different, there would have been no egg-headed *Homo sapiens*.

That view is being questioned. For example, in a study published last year in the *Proceedings of the National Academy of Sciences* a group of researchers looked at crustaceans (crabs, shrimps, woodlice and so on) over the past 550m years and found far more examples of groups of species evolving towards complexity than in the other direction. Matthew Wills of the University of Bath, in England, commented at the time that it was the "nearest thing to a pervasive evolutionary rule that's been found." In this study, the only crustaceans that became simpler were either parasites or those living in remote habitats, such as isolated marine caves.

Simon Conway-Morris, a palaeontologist at Cambridge University, in England, is the champion of a new interpretation of evolution—one that challenges the view that it is largely governed by the accident of circumstances. Unlike Gould, he thinks that if evolution were replayed from the beginning, a lot of things would turn out the same.

Dr Conway-Morris has arrived at this view from a detailed study of what is known as convergent evolution. Darwin himself was intrigued by this phenomenon, in which different groups of organisms independently evolve similar solutions to similar problems, whether these solutions are teeth, eyes, brains, ecosystems or societies. Where other biologists have noted such convergences as "remarkable", Dr Conway-Morris believes they actually tell a broader story.

His argument is that, given the nature of physics and chemistry, there may be only a limited number of ways in which things can work. Evolution will be channelled into these successful paths, and thus does have trends. Two of these, he thinks, are towards complexity and intelligence. He adds that things "don't just happen in chemistry". They happen because of pre-existing causes. Whether it is the molecules of crystallin that are used to build an eye or the haemoglobin that makes blood carry oxygen, the nature of molecules themselves means that evolution is more likely to follow a path determined by their basic structure. Evolution is a mechanism, and it works within rules.

Dr Conway-Morris's view of the world may or may not turn out to be correct. If it is, it may prove more palatable to some people than the current interpretation of the biological world as ultimately materialist and purposeless.

Darwin himself was deeply troubled by his materialist thoughts and what they meant. He considered how thoughts and emotions were simply secretions of the brain. From his correspondence it seems his religious beliefs never reached a fixed position, but he was sensitive to the extent to which his ideas could upset others. He even devised a diplomatic answer that avoided challenging the existence of God. When asked about the origins of emotions, instincts and degrees of talent, he noted, "say only they are so because brain of child resembles parent's stock".

More to know

Dr Conway-Morris is not convinced by Gould's arguments. He thinks there is unfinished business to deal with. On the source of moral systems and consciousness, he says, "we are nowhere near an answer". In his world, science can explain the beetle, the lotus leaf and the spider's web, but not why they appear beautiful to people. Others think that the explanation is memes, the cultural equivalent of genes in which ideas replicate through the human desire to imitate.

In some ways, though, it does not matter whether humanity's evolution was entirely random or was predictable in its general form. For people do, now, have a united evolutionary common purpose: to halt that natural selection in its tracks. The species has evolved to the point where it understands itself, and can seek to escape the brutal handcuffs of nature and end the struggle for existence. The beginning of that understanding was provided by Darwin, and the application of Darwinism will be an important part of the process. That gives people every reason to celebrate his 200th birthday.

The Richard Casement internship

Feb 5th 2009
From The Economist print edition

We invite applications for the 2009 Richard Casement internship. We are looking for a would-be journalist to spend three months of the summer working on the newspaper in London, writing about science and technology. Our aim is more to discover writing talent in a science student or scientist than a scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves and an original article of about 600 words that they think would be suitable for publication in the science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. A small stipend will be paid to the successful candidate. Applications must reach us by February 20th. They should be sent to: casement2009@economist.com.

Liberalism

Anatomy of an idea

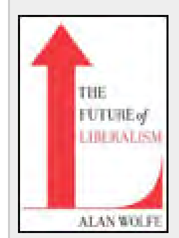
Feb 5th 2009
From The Economist print edition

Bridgeman Art Library



Barack Obama shuns the L-word. But his speeches brim with liberal ideas and ideals. What is it about the doctrine that dare not speak its name?

The Future of Liberalism
By Alan Wolfe



Knopf; 352 pages; $25.95

AUTHORS who defend liberalism must often struggle just to get the word out without facing incomprehension or abuse—even today. To the left, particularly in Europe, liberalism means the free-market dogma of clever simpletons who created the present financial mess. The American right's complaint is quite different. Forget that Hamilton, Jefferson and Madison fathered liberalism in the United States. For nigh on 30 years conservative Republicans persuaded American voters that liberals were godless, amoral, tax-happy hypocrites.

Intellectually, little of either charge makes sense. Twinned with "democracy", as in what the West stood up for during the cold war, "liberal" was a term of pride. Since communism failed, the case for liberal democracy has only strengthened. Think of outstanding alternatives: illiberal Russia, undemocratic China, populist Venezuela, theocratic Iran.

Odder still, put this question to people who live, or would like to live, in a liberal democracy: "Which of the following values do you espouse—personal freedom, rule of law, active but accountable government, free but responsible markets, mutual toleration and equal concern for all?" It is a fair bet that people will tick most or all items on this list. Ask them if they are liberals, on the other hand, and many will turn contemptuously away.

That 20th-century connoisseur of doublespeak, George Orwell, would not have been surprised. Political language, it seems, has taken leave of political facts. Alan Wolfe, a professor of politics at Boston College, thinks it time to reunite them. His welcome and readable essay lays out what he thinks liberalism really amounts to and why it demands support.

Liberal politics, on his account, is rooted in a view of what matters in a human life. A gifted guide, he opens with a brisk Grand Tour of the liberal tradition. Glimpses of leading thinkers and the human values

they argued for include Immanuel Kant (moral and intellectual autonomy), Benjamin Constant (protection from arbitrary power) and John Stuart Mill (promotion of human individuality).

The link with politics is that those three values all involve freedom. Whatever else it is, liberalism is about nourishing human liberty. Where liberals disagree is how that fits with a second powerful ideal, equality.

Right-wing liberals contrast “classical”, small-government liberalism and the modern, active-government kind. The one, so they claim, leaves people free while the other wrongly infringes freedom on behalf of equality. That story became popular in the 1970s, both as a history of liberalism and as a view of government’s limits.

Mr Wolfe, like other left-wing liberals, finds the contrast historically inept and conceptually confused. Making enemies of freedom and equality ignores, in his view, the democratic presumption that any one person’s liberty matters as much as the next person’s. It is deaf also to the fact that modern citizens’ freedoms are often limited by big social forces beyond their control. If all citizens are to be free in any effective sense, they require help from countervailing forces. Government is one such force.

If, the argument goes on, you take concern for everyone’s liberty seriously, you will treat the proper scale of government as a matter of circumstance, not principle. At times, government is overweening and ought to be cut back. At others, active government is required to steady markets, help the needy or serve the public good. Put abstractly, government may be called on to foster or restore equal liberty. Pragmatic, socially minded liberalism of that kind underpinned American and British government, from the New Deal until Ronald Reagan, from Clement Attlee to Margaret Thatcher. It seems, from necessity, to be with us again.

Mr Wolfe touches many topics. He defends liberals against the charge that they seek, illiberally, to keep religion and morals out of public life. In his most policy-minded section, he traces how liberal commitment to openness plays out with regard to free speech, immigration and transparent government. He notes the illiberal undertow of what he nicely calls “self-incapacitation books”, or popular-science writing in behavioural economics and evolutionary psychology claiming to show what little part reason and responsibility play in how we behave. He rebuffs the frequent charge that liberals are wobblers or dreamers. The true liberal temper, he tells us, is realistic, ironic and disabused.

Through no fault of Mr Wolfe’s, this fine defence of liberal values risks seeming to lag behind the news. He completed his book before Wall Street imploded, the American economy slumped and Barack Obama won the White House. Whether or not they buy the reasoning behind it, many readers will think Mr Wolfe’s call for active government is now merely pushing at an open door.

Faster than anyone expected, the argument among liberals has shifted. It is no more about active versus limited government, but about what active government should be doing. On that Mr Wolfe could have said more. No one with an open mind, however, can come away from “The Future of Liberalism” treating “liberal” as a term of abuse. Before long, who knows, even Mr Obama may drop his reserve and embrace the word with pride.

The Future of Liberalism.
By Alan Wolfe.
Knopf; 352 pages; $25.95

Iran and the West

Talking past each other

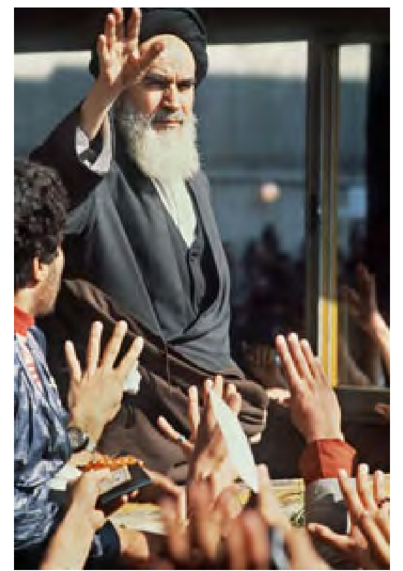
Feb 5th 2009
From The Economist print edition

Iran is in the air. An impressive three-hour television documentary and a new book (see article) mark the 30th anniversary of Ayatollah Khomeini's revolution

NORMA PERCY has ways of making you talk. Persuasiveness served the American-born, London-based television producer well in the past, with such films as "The Death of Yugoslavia" and "Israel and the Arabs: Elusive Peace". She has done it again in her newest venture, a three-part series on Iran's tricky relationship with America and Europe.

"Iran and the West" will be broadcast in Britain by the BBC, starting on February 7th, although it is not clear yet whether it will also be shown on the corporation's new Persian TV channel, which was launched last month. The series has been sold in 13 countries and will be aired in the coming weeks in America, Japan, Canada, Australia and much of western Europe.

AFP



The man who started it all

Ms Percy's model is to persuade the main participants—presidents, foreign ministers, generals and close advisers—to describe what they did at crucial moments of political crisis. The key lies in obtaining the first interviews. After that, few want to be left out. The main players have their say and viewers get a good idea of how those involved come to make complex decisions about foreign policy and realpolitik and then undo the damage they cause.

Three years in the making and finished just days before the 30th anniversary of Ayatollah Khomeini's return from exile to Tehran on February 1st (see article), "Iran and the West" shows how Khomeini changed the world by taking Iran and making it the inspiration for a new and uncompromising strand of Islam. It conveys the strains, for both Iran and America, of dealing with the daily tumult of the Islamic revolution and the long siege of the American embassy in Tehran. And it goes on to analyse the fallout from the Iran-Iraq war, the crucial role Iran played in creating Hizbullah, the Shiite militia's wrongdoings in Lebanon, as well as Iran's more recent meddling in Iraq and its ambitions to join the small club of nuclear nations.

By the mid-1980s the hatred between Iran and the West was so strong that the normal rules governing how states behave towards each other were set aside. Europe and America armed Iran's foe, Saddam Hussein, and turned a blind eye when he used chemical weapons on Iranian troops as well his own people. Yet, far from being an anti-Iranian polemic, "Iran and the West" chronicles three decades of mistakes, misunderstandings and missed opportunities, especially in the relationship with America. Two long interviews—with Hashemi Rafsanjani, Iran's reformist president from 1989 until 1997, and his successor, Muhammad Khatami—obtained at the eleventh hour and in the face of disapproval from the Iranian Ministry of Culture and Islamic Guidance, add depth and crucial detail to a narrative that could so easily have been too Western.

The film highlights several vital events. Two Iranian revolutionary guards describe organising the takeover of the American embassy and confirm what others maintain, that, contrary to rumour, the current president, Mahmoud Ahmadinejad, refused to be involved in the siege. Sheikh Subhi al-Tufeyli, Hizbullah's first secretary-general, recounts how the release of three French hostages from Lebanon in 1988 had been delayed for two years at the behest of the French right-wing opposition parties who wanted to destabilise President François Mitterrand's Socialist Party and help Jacques Chirac become prime minister. Vladimir Putin, then Russia's president, describes how, after the assassination of Ahmad Shah Massoud, an Afghan warlord, in early September 2001, he telephoned the American president, George Bush, to warn him that al-Qaeda was planning "something big". The attack on the twin towers happened the next day. Documentary-making at its best.

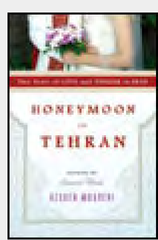
Tehran memoir

Mulberry milkshake

Feb 5th 2009
From The Economist print edition

AZADEH MOAVENI is a young Iranian-American reporter for *Time* who spent a couple of years in Tehran during and after Mahmoud Ahmadinejad's election in 2005. During this time, she got pregnant and married—a sequence that was awkward in puritan Iran—had a lot of fun and with light-fingered shrewdness has written a book that helps explain why things have turned out as they have.

Honeymoon in Tehran: Two Years of Love and Danger in Iran
By Azadeh Moaveni



Random House; 352 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

On an earlier visit to Iran she had found the educated young desperate for change. Now she found apathy: the slight loosening of social strictures had eased middle-class discontent, but after the failure of the reformists few bothered to vote. They had not noticed that Iran's poor, more concerned with economic inequality than reform, were responding to a fiery young fundamentalist.

Nearly everyone she meets reviles Mr Ahmadinejad and, despite his promises, the poor remain poor. Yet he has become something of a national hero, particularly for standing up to the West. When reports emerged that America was plotting to overthrow the Islamic regime, everything hardened. And made life worse for Ms Moaveni. Up to then, she had managed pretty well. The Iranian women she knew "were more independent than any generation before them", negotiating their way round the laws on behaviour and dress with guile and good sense. She and they managed for the most part to do what they wanted (one of her girlfriends is a racing driver) without making a big fuss about the multiple absurdities. But in the face of the American threat, the hardliners began clamping down capriciously.

As a correspondent, she had always reported what she was doing to a creepy security agent, known as Mr X, an unpleasant business but, until then, no more than that. Suddenly, Mr X seemed to get threatening and Ms Moaveni called it a day.

So she, her husband and small boy departed for London. Though Iran's ruling fundamentalists make life tiresome, and sometimes much worse, for the secular majority, it's still a hard place to leave. No more jasmine-scented nights in Shiraz, no more lively gossips with friends over a "pistachio milkshake topped with mulberries". Ms Moaveni is clever at conveying Iran's continuing allure.

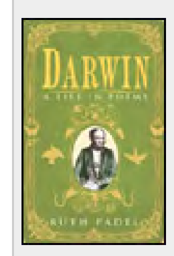
Honeymoon in Tehran: Two Years of Love and Danger in Iran.
By Azadeh Moaveni.
Random House; 352 pages; $26

Charles Darwin

A life in poems

Feb 5th 2009
From The Economist print edition

Darwin: A Life in Poems
By Ruth Padel



Chatto & Windus; 160 pages; £12.99. To be published in America by Knopf in March; $26

Buy it at
Amazon.com
Amazon.co.uk

BIOGRAPHIES can be wearisome contrivances, often too long and too detailed for their own good. Biographers make the mistake of spending too much time worshipping at the altar of their subjects. Think of the magisterial, three-volume life of Robert Frost by Lawrence Thompson, for example, and how the biographer passed, over the many years of its making, from hero worship to intense dislike of the poet he shadowed for almost a quarter of a century. Yes, too long and intense an acquaintance can lead to sourness.

As the bicentenary of Charles Darwin's birth on February 12th approaches, it is good to welcome a biography which is relatively small, but in no way superficial or scanty. Ruth Padel has achieved this feat by writing her great-great-grandfather's life in a sequence of often quite short poems. Through her verses she seeks to capture the "voice" of Darwin, thus performing a difficult act of literary ventriloquism. Ms Padel, who often writes about animals, embeds many of Darwin's own words—from his books or his letters—in her poems, and the results tend to give the sense of being jointly authored. Sometimes she shapes entire gobbets of quotation into her own poetic passages. If this seems to be a bit of sly plagiarism, it doesn't feel like it. It feels more like a deft act of collaboration between the living and the dead, one melding easily with the other.

Why does this book work so well? How does it manage to say so much in so few words? Ms Padel seems to have caught the quintessence of the man's character, as if in a butterfly net. She enters into his cast of mind, bringing across his hypersensitivity, his sense of fragility, his lifelong nerviness, the way in which the canker of doubt about the credibility of religious doctrine ate away at him. The poems are a sequence of snapshots—often small, spasmodic and delicately imagistic—of particularly crucial incidents in his life; of moments of intellectual illumination.

One of the finest poems summarises his wonder at entering, for the first time, into pristine rainforest. It is a bit like a photograph album with audio commentary. The poems are wonderfully free of the drag and load of overbearing and perfectly useless detail with which so many second-rate biographies are stuffed to the gills. Most important of all, they seem to distil Darwin to his essence. He was a compulsively inquisitive child. He was also fearful. In part, he feared himself and his roving intellect. His inability to believe in the Christian god put him at odds with his beloved wife, Emma, and made him feel as if he lived set apart in some cold, far galaxy of the mind.

It is not easy to describe a whole life in relatively few words. You need to find some way of filling in the background. Ms Padel has overcome this problem by having paragraphs of notes run, in a single column, beside the texts of the poems so that they can be read side by side.

And why are poems a good way of illuminating a life such as Darwin's? The best lyric poems—think of Keats or Shelley, for example—are moments of epiphany, a sudden opening out onto magic casements. And Darwin, throughout, was in the grip of something very similar: a terrible, destabilising sense of wonder. He sensed intimations of the marvellous everywhere he looked. All the sadder then—and this is something that Ms Padel does not explain—that, later in life, the man who carried with him on the *Beagle* a copy of Milton's "Paradise Lost" found that he could no longer enjoy poetry.

Darwin: A Life in Poems.
By Ruth Padel.
Chatto & Windus; 160 pages; £12.99. To be published in America by Knopf in March; $26

The euro

Currency affairs

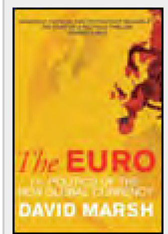
Feb 5th 2009
From The Economist print edition

EUROPE'S single currency is now a sprightly ten-year-old. Sceptics had not expected it to live so long, so its rude health is something of a triumph. In different ways these two books, one by a former journalist for the *Financial Times* and the other by a former director of the European Central Bank (ECB) who was also its first chief economist, celebrate this success.

AP



The Euro: The Politics of the New Global Currency
By David Marsh



Yale University Press; 352 pages; $35 and £25

Buy it at
Amazon.com
Amazon.co.uk

The Birth of the Euro
By Otmar Issing



Cambridge University Press; 296 pages; $29.99 and £15.99

Buy it at
Amazon.com
Amazon.co.uk

David Marsh's forthcoming book is more gripping, especially on the run-up to the euro's birth. He has a detached, even sceptical tone, whereas Otmar Issing, whose book came out last October, is more of a fervent believer. Mr Marsh's book has extra value because it draws on hundreds of interviews with the bigwigs involved in setting up the euro (including Mr Issing, whom he interviewed twice) and is built on the foundation of his earlier history of Germany's Bundesbank. The result is an indispensable guide to monetary union.

The most interesting part of Mr Marsh's tale comes in the early 1990s; not the negotiations before the 1992 Maastricht treaty but the huge strains within Europe's exchange-rate mechanism (ERM), with other currencies repeatedly pushed to their floors against the Deutschmark. In earlier periods the solution would have been devaluation. But countries such as Britain and France fiercely resisted this, partly because they considered, with some reason, that the problem was one of Deutschmark strength, not their own weakness.

In the end France, much helped by the stubbornness of its then treasury director, Jean-Claude Trichet (now the ECB's president), stayed in an ERM with wider trading bands. But Britain (like Italy) was ignominiously forced out. These countries' attitudes to the single currency still owe much to their experience. And some tensions inherent in the ERM can still be detected in today's euro. The difference is that now they emerge in pressure on bond yields and ballooning current-account and budget deficits, rather than in dramatic foreign-exchange crises.

Germany was always reluctant to lose the Deutschmark and the Bundesbank. It came round to the euro for two reasons: the enthusiasm of Chancellor Helmut Kohl, especially after German unification; and the care taken to create the new currency on German (ie, Bundesbank) lines. The Maastricht criteria, the stability-pact limits on budget deficits and the ECB's extreme independence were all aimed to calm German worries. Even then, as Mr Issing makes clear, the Bundesbank believed the single currency needed greater political union.

Mr Issing's book is good on the technicalities of setting up the ECB and designing its (mostly successful) monetary policy, even if he is too defensive over its early communication failures. At one point, he says tartly that "a central bank is not established with the primary aim of communicating with the public." Ironically, given German opposition to the candidacy of Mr Trichet as ECB president, he has proved a more effective communicator than his Dutch predecessor, Wim Duisenberg.

It is a further irony that Germany at first suffered under the euro, with slow growth and an embarrassing breach of the stability pact. But now other countries look more vulnerable. Their hope had been to

shackle the Germans via the euro, but now they find themselves at a competitive disadvantage without the option of devaluing. Indeed, these two books suffer from an accident of timing. Today euro members like Spain, Ireland, Greece and Portugal suddenly find their credit ratings under threat and their bond spreads over Germany's widening sharply. For all the success of its first ten years, this year looks likely to be the euro's most testing so far.

The Euro: The Politics of the New Global Currency.
By David Marsh.
Yale University Press; 352 pages;$35 and £25

The Birth of the Euro.
By Otmar Issing.
Cambridge University Press; 296 pages; $29.99 and £15.99

Pierre Bonnard

Meditating on modernism

Feb 5th 2009 | NEW YORK
From The Economist print edition

A French master reassessed

HISTORY has been all wrong about Pierre Bonnard. This painter of shimmering landscapes, bathers and interiors, born in 1867, is not a latter-day Impressionist after all. He was a modernist, a man looking forward not back. That, at least, is the argument put forward in an exhibition of 80 of his works which opened recently at the Metropolitan Museum of Art in New York and runs until April 19th. This is the first show devoted solely to Bonnard's late still-lifes and interiors, and it is a thought-provoking exhibition.

The chronological display begins with the 1923 "Still Life With Greyhound", with its echoes of Jean-Siméon Chardin; it ends, in a blaze of yellow and orange, with "Bouquet of Mimosas", painted in 1945, just two years before his death. Walking through the circular, artificially lit display, it becomes clear that this French artist belongs to no "ism" whatsoever. After his early association with the Nabis, a group that came together in the 1890s and included Edouard Vuillard, Bonnard clearly went his own way.

ARS



Looking for light's memory

Much of the work on view was produced after 1926, when Bonnard and his model, muse and wife, Marthe, moved into "Le Bosquet", an unimposing villa above Cannes. But the many bowls and baskets of luscious-looking peaches and cherries, the plates of cakes and the roses in jugs are not the careful arrangements one would expect a still-life artist to create. The reason for this is that Bonnard did not paint from life. What we see are his memories. To help him recall images that captivated him, the artist always carried a small pocket diary. On its ruled pages he made pencil sketches. Whether his inspiration was a person, an animal, plants or the corner of a room, though, light was his main prey. To help him capture it, he jotted down notes about weather and colours. In one of the four notebooks on display, for example, the words *pluvieux froid* (rainy, cold) are scrawled across the top of a page.

There was nothing of the romantic artist in a garret about Bonnard. He appeared to live a bourgeois life. His studio was a smallish upstairs bedroom; it didn't even have an easel. He would just cut off lengths of canvas and tack them to the wall. When a picture was finished, he cropped off any remaining blank canvas.

Henri Matisse, his near contemporary, was a close friend; "Work Table", finished in 1937, shows his influence. Like Matisse, Bonnard has been dismissively labelled a decorative artist, a painter of happiness. This exhibition should put an end to that. The 1946 "Portrait of the Artist in the Bathroom Mirror" is almost terrifyingly bleak. "Bouquet of Mimosas", painted the year before, offers no hope-filled, sweetly perfumed vision of early spring. Instead, it conjures up a deadly poison that seems to seep out of the flowers.

Although planned well before the current financial crisis, this is the kind of small, focused exhibition visitors can expect in the coming year. But too much has been edited out. Among the cherished, famous paintings that are absent are the bedazzling landscapes from the Phillips Collection in Washington, DC. Dita Amory, the show's chief curator, explains that these, and indeed all the pictures painted before 1923, were deliberately omitted. Yet even she admits the arbitrariness of defining "late" as work done after the painter's 55th birthday.

In any case, Bonnard painted many fine landscapes after this, and a number of much-loved bathers. Where are they? Their absence penalises both artist and viewer. It is doubtful that the concentration on less-well-known pictures (many of them seldom-seen loans from private collections) will convince people

that Bonnard is, as Ms Amory claims, a modernist. But even without some of his greatest pictures, Bonnard's singular vision shines through. "One always talks of surrendering to nature," he said. "There is also such a thing as surrendering to the picture." Bonnard often spent years on a painting. For him, painting was not only remembering. It was also a meditation. Visitors to this show would be well advised to stand still before the results. It takes time to perceive fully what he was trying to say.

Correction: The YSL/Pierre Bergé sale

Feb 5th 2009
From The Economist print edition

In our report on Christie's sale of the Yves Saint Laurent/Pierre Bergé collection ("Scattered to the winds", January 31st), we mistakenly described Yve-Alain Bois, who contributed to the sale catalogue, as being at Princeton University. He is, in fact, a professor in the School of Historical Studies at the Institute for Advanced Study, which is based in Princeton, New Jersey, but is not associated with the university. Our apologies.



Anastasia Baburova

Feb 5th 2009
From The Economist print edition

Anastasia Baburova, a Russian journalist, died on January 19th, aged 25

AP



IT IS still not clear why Anastasia Baburova was shot in the head. Was she a target—along with Stanislav Markelov, a human-rights lawyer who was shot seconds earlier? Was she an accidental victim, in the wrong place at the wrong time? Or did she try to grab and disarm the killer after he shot her companion?

Both Mr Markelov and Ms Baburova were killed in broad daylight in the centre of Moscow. The next day, a party of Russian nationalists brought champagne to the murder scene to celebrate the "elimination" of their enemies. Her death was part of a continuing battle between fascists and anti-fascists in Russia, which is seldom so plainly revealed to the outside world.

Jumping an assassin was part of her nature. At any sign of violence or racism her nerves and muscles instantly responded, hitting out, resisting what was physically intolerable. "It is hard to look in the eyes of a Korean student who has just been hit on the head by two under-age jerks…giving 'Heil Hitler' salutes", she wrote in her blog after seeing yet another neo-Nazi attack in Moscow. It was the same blog in which she enthused about roller-blading for the first time: at night, fast, without a helmet.

The fact that she worked at *Novaya Gazeta* was no coincidence. "Where else?" she asked her colleagues, rhetorically. She was the fourth journalist *Novaya Gazeta* had lost in the past eight years. But Russia's most critical newspaper, co-founded by Mikhail Gorbachev, the architect of *perestroika*, was the natural place for her to be.

Stretching towards the sun

She was born in 1983, just before *perestroika* opened up the country. Like the best of her generation (alas, few and untypical) she grew up fearless, thriving on freedom and fresh air. Ms Baburova considered herself a citizen of the world; she had more in common with rebellious youths in Europe than with office workers in her own country. She spoke fluent English and learnt Chinese; yet she had little chance to go abroad, to London or anywhere else. Instead, she travelled through books. At 15 her restlessness was compressed in a poem called "Coffee Cup":

Wake up in the morning
Stretch your arms towards the sun
Say something in Chinese
And go to Paris...
Every minute, somewhere in the world there is morning
Somewhere, people stretch their arms towards the sun
They speak new languages, fly from Cairo to Warsaw
They smile and drink coffee together.

Official patriotic slogans ("A resurgent Russia that is getting off its knees") sounded false and alien to her. She was never on her knees, never humiliated by the Soviet collapse, even though she was born in Sebastopol—a Black Sea port redolent with past Russian glory—when it was part of the Soviet empire, and went to school there when it had become part of Ukraine. Instead of feeling inferior, she learnt martial arts. She managed to get into the Moscow Institute of International Relations (MGIMO), where the children of the Soviet elite traditionally prepare themselves for diplomatic careers—a miracle for a girl from Sebastopol, without connections. Her exam results were so impressive that she was offered a place at Yale. But she decided she wanted to be a journalist, and walked out of the institute.

She could have made a career at *Izvestia*, and did a short stint there, but never fitted in at a newspaper which in recent years has exuded nationalism, conformism and cynicism. She got into trouble for showing her press card, and was arrested for filming police evicting residents from a building which they had claimed for themselves. Vladimir Mamontov, the editor of *Izvestia*, who never met Ms Baburova, dismissed her as the type of girl "who knows very little about real life, but vibrates at the sight of a social change. They are waiting for a revolution, and when there is none they get bored."

Dmitry Muratov, the editor of *Novaya Gazeta*, knew her better. She reminded him of the young men who people Dostoevsky's novels, youths with a heightened sense of injustice and a longing to change the world. Though her family came from the Soviet intelligentsia, her roots went back further, to the 19th-century thinkers who invented the word. Unsurprisingly, Ms Baburova had a soft spot for anarchists. Mikhail Bakunin, for example, who believed that without inner freedom for the individual, society can be neither free nor fair.

She and her friends rightly identified fascism as the biggest and most pressing threat to her country. She swore to fight it. She sensed accurately the social kinship between Stalinism and fascism: the link between attempts to portray Stalin as a "successful manager", and the current upsurge of nationalism. Unlike many young people in the generation before hers, she did not see a safe job as an ultimate measure of success.

In Turgenev's poem "The Threshold", a young woman stands before a door. A voice asks whether she is prepared to endure cold, hunger, mockery, prison and death, all of which await her on the other side. She says "Yes" to everything, and steps over. "A fool," cries a voice from behind her. "A saint," suggests another.

Overview

Feb 5th 2009
From The Economist print edition

America's GDP fell at an annualised rate of 3.8% in the fourth quarter, the largest decline since 1982. Firms increased their stock levels after having run them down in the previous quarter: the adjustment added 1.3 percentage points to GDP growth. There were signs that the drop in output in this quarter will be less steep than feared. The Institute for Supply Management's (ISM) manufacturing index picked up from 32.9 to 35.6 in January. The ISM index of non-manufacturing activity rose from 40.1 to 42.9.

There were signs that America's **housing market** may be reviving. The National Association of Realtors reported that pending home sales—when a contract has been agreed on but not completed—rose by 6.3% in December. Sales rose fastest in the Midwestern and Southern regions, where resales of foreclosed homes are less common.

Consumer-price inflation in the **euro area** fell from 1.6% to 1.1% in January, based on a preliminary estimate. An index of activity in both manufacturing and services edged up in January from a record low. The number of people claiming unemployment benefits in **Spain** rose to 3.3m, more than a million higher than the previous January. The jobless rate in **Ireland**, based on benefit claimants, jumped from 8.3% to 9.2% in January.

The Reserve Bank of **Australia** cut its benchmark interest rate by a percentage point, to 3.25%, the lowest for 45 years. **Norway's** central bank cut its main interest rate from 3% to 2.5%. **Indonesia's** central bank lowered its interest rate from 8.75% to 8.25%.



Output, prices and jobs

Feb 5th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	−0.2 Q4	−3.8	+1.2	−2.0	−7.8 Dec	+0.1 Dec	+4.1	+3.8	7.2 Dec
Japan	−0.5 Q3	−1.8	−0.2	−3.2	−20.6 Dec	+0.4 Dec	+0.7	+1.4	4.4 Dec
China	+6.8 Q4	na	+9.0	+6.0	+5.7 Dec	+1.2 Dec	+6.5	+5.9	9.0 2008
Britain	−1.8 Q4	−5.9	+0.7	−2.6	−6.9 Nov	+3.1 Dec§	+2.1	+3.6	6.1 Nov††
Canada	+0.5 Q3	+1.3	+0.5	−0.7	−5.1 Nov	+1.2 Dec	+2.4	+2.4	6.6 Dec
Euro area	+0.6 Q3	−0.7	+0.8	−2.1	−7.7 Nov	+1.1 Jan	+3.2	+3.1	8.0 Dec
Austria	+1.5 Q3	+0.6	+1.4	−1.3	+0.7 Nov	+1.3 Dec	+3.6	+3.2	3.8 Nov
Belgium	+1.3 Q3	+0.4	+1.3	−1.3	−11.6 Nov	+2.3 Jan	+3.5	+4.5	10.8 Dec‡‡
France	+0.5 Q3	+0.5	+0.7	−1.7	−9.0 Nov	+1.0 Dec	+2.6	+2.8	8.1 Dec
Germany	+0.8 Q3	−2.1	+1.1	−2.5	−6.3 Nov	+0.9 Jan	+2.8	+2.6	7.8 Jan
Greece	+3.1 Q3	+2.0	+1.1	−1.8	−5.9 Nov	+2.0 Dec	+3.9	+4.1	7.4 Oct
Italy	−0.9 Q3	−2.1	−0.6	−2.3	−9.7 Dec	+2.2 Dec	+2.6	+3.3	6.7 Q3
Netherlands	+1.8 Q3	+0.1	+1.8	−1.6	−6.2 Nov	+1.9 Dec	+1.9	+2.3	3.9 Dec††
Spain	+0.9 Q3	−0.9	+1.1	−2.3	−15.4 Dec	+1.4 Dec	+4.2	+3.9	13.4 Nov
Czech Republic	+4.2 Q3	+3.8	+4.2	+0.8	−17.4 Nov	+3.6 Dec	+5.4	+6.5	6.0 Dec
Denmark	−1.2 Q3	−1.9	−0.6	−1.7	−6.8 Nov	+2.4 Dec	+2.3	+3.5	2.1 Dec
Hungary	+0.8 Q3	−0.3	+0.8	−3.0	−12.0 Nov	+3.5 Dec	+7.4	+6.2	8.0 Dec††
Norway	+0.6 Q3	−2.8	+1.8	−0.2	+0.1 Nov	+2.1 Dec	+2.8	+3.8	2.9 Nov***
Poland	+4.8 Q3	na	+5.1	+2.9	−4.4 Dec	+3.3 Dec	+4.0	+4.3	9.5 Dec‡‡
Russia	+6.2 Q3	na	+6.0	+1.0	−10.8 Dec	+13.4 Jan	+12.6	+14.1	7.7 Dec‡‡
Sweden	nil Q3	−0.4	+0.6	−1.0	−11.9 Nov	+0.9 Dec	+3.5	+3.4	6.4 Dec‡‡
Switzerland	+1.7 Q3	+0.1	+1.8	−1.0	+0.7 Q3	+0.7 Dec	+2.0	+2.3	2.8 Dec
Turkey	+0.5 Q3	na	+2.3	+0.4	−13.9 Nov	+11.1 Jan	+8.2	+10.5	10.3 Q3‡‡
Australia	+1.9 Q3	+0.3	+2.2	+0.3	+3.8 Q3	+3.7 Q4	+3.0	+4.4	4.5 Dec
Hong Kong	+1.7 Q3	−2.0	+3.0	−3.0	−6.7 Q3	+2.1 Dec	+3.8	+4.2	4.1 Dec††
India	+7.6 Q3	na	+5.3	+5.0	+2.4 Nov	+9.7 Dec	+5.5	+8.2	6.8 2008
Indonesia	+6.1 Q3	na	+6.1	+3.5	+1.9 Nov	+9.2 Jan	+5.6	+10.4	8.4 Aug
Malaysia	+4.7 Q3	na	+5.1	−0.3	−7.7 Nov	+4.4 Dec	+2.4	+5.5	3.1 Q3
Pakistan	+5.8 2008**	na	+6.0	+1.2	−1.2 Nov	+23.3 Dec	+8.8	+20.3	5.6 2007
Singapore	−3.7 Q4	−16.9	+1.9	−2.9	−13.5 Dec	+4.3 Dec	+4.4	+6.6	2.6 Q4
South Korea	−3.4 Q4	−20.8	+4.1	−2.8	−18.6 Dec	+3.7 Jan	+3.9	+4.9	3.3 Dec
Taiwan	−1.0 Q3	na	+1.8	−3.5	−32.3 Dec	+1.6 Jan	+2.9	+3.5	5.0 Dec
Thailand	+4.0 Q3	+2.3	+3.4	−1.0	−18.8 Dec	−0.4 Jan	+4.3	+5.5	1.1 Sep
Argentina	+6.2 Q3	+5.4	+5.5	−1.8	−7.2 Nov	+7.2 Dec	+8.5	+8.6	7.3 Q4‡‡
Brazil	+6.8 Q3	+7.4	+5.3	+1.6	−14.5 Dec	+5.9 Dec	+4.5	+5.7	6.8 Dec‡‡
Chile	+4.8 Q3	−0.2	+3.5	+1.0	−3.7 Dec	+7.1 Dec	+7.8	+8.7	7.5 Dec††‡‡
Colombia	+3.1 Q3	+2.9	+2.7	−0.5	−13.3 Nov	+7.7 Dec	+5.7	+7.0	10.8 Nov‡‡
Mexico	+1.6 Q3	+2.6	+1.8	−1.4	−5.4 Nov	+6.5 Dec	+3.8	+5.1	4.3 Dec‡‡
Venezuela	+4.6 Q3	na	+4.9	−3.0	+2.7 Sep	+30.7 Jan	+24.1	+30.4	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+7.2	+4.9	+7.3 Q3	+18.3 Dec	+6.9	+18.3	8.6 Q3‡‡
Israel	+5.1 Q3	+2.3	+4.1	+0.9	+1.8 Oct	+3.8 Dec	+3.4	+4.5	5.9 Q3
Saudi Arabia	+3.5 2007	na	+4.2	+0.4	na	+9.5 Nov	+4.8	+9.4	na
South Africa	+2.9 Q3	+0.2	+3.0	+1.0	−4.4 Nov	+9.5 Dec	+9.0	+11.3	23.2 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−3.5 Q3	na	−2.3	−3.3	−20.7 Dec	+7.0 Dec	+9.6	+10.4	8.3 Nov
Finland	+1.3 Q3	+0.4	+1.6	−1.3	−15.6 Dec	+3.5 Dec	+2.6	+4.1	6.6 Dec
Iceland	−0.8 Q3	−5.5	−0.5	−9.7	+0.4 2007	+18.6 Jan	+5.8	+13.8	4.8 Dec‡‡
Ireland	+0.1 Q3	+4.7	−2.9	−4.0	+2.8 Nov	+1.1 Dec	+4.7	+4.2	8.3 Dec
Latvia	−4.6 Q3	na	−1.8	−8.0	−14.2 Dec	+10.5 Dec	+14.1	+15.4	9.0 Nov
Lithuania	−1.5 Q4	−9.3	+4.4	+1.6	na	+8.5 Dec	+8.1	+11.2	5.7 Dec‡‡
Luxembourg	−0.3 Q3	−5.5	+2.1	−2.2	−9.8 Oct	+1.1 Dec	+3.4	+3.4	4.7 Nov‡‡
New Zealand	−1.4 Q3	−2.7	−0.9	−1.9	−0.5 Q3	+3.4 Q4	+3.2	+4.3	4.6 Q4
Peru	+5.1 Nov	na	+9.1	+3.1	+5.1 Nov	+6.5 Jan	+4.2	+5.8	8.1 Dec‡‡
Philippines	+4.5 Q4	+4.1	+4.3	+1.4	−6.6 Nov	+8.0 Dec	+3.9	+9.6	6.8 Q4‡‡
Portugal	+0.6 Q3	−0.5	+0.3	−2.0	−6.2 Nov	+0.8 Dec	+2.7	+2.6	7.7 Q3‡‡
Slovakia	+7.0 Q3	na	+6.8	+2.0	−7.1 Nov	+4.4 Dec	+3.4	+4.6	8.4 Dec‡‡
Slovenia	+3.8 Q3	na	+4.2	+1.4	−12.0 Nov	+2.1 Dec	+5.6	+5.7	6.7 Nov‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 0.9% in Dec. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Feb 5th 2009
From The Economist print edition

The Economist commodity-price index
2000=100

	Jan 27th	Feb 3rd*	% change on one month	% change on one year
Dollar index				
All items	161.2	157.6	-5.8	-32.2
Food	191.4	186.4	-4.8	-19.4
Industrials				
All	122.1	120.3	-7.8	-48.5
Nfa†	116.3	114.3	-3.0	-37.6
Metals	125.3	123.6	-10.0	-52.7
Sterling index				
All items	172.5	166.5	-3.6	-6.1
Euro index				
All items	113.2	112.4	-2.8	-22.8
Gold				
$ per oz	900.05	906.80	+7.3	-2.2
West Texas Intermediate				
$ per barrel	42.05	41.04	-15.5	-55.2

*Provisional †Non-food agriculturals.

The Economist poll of forecasters, February averages

Feb 5th 2009
From The Economist print edition

The Economist poll of forecasters, February averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2008	2009	2008	2009	2008	2009	2008	2009
Australia	1.6/2.4	−0.5/1.5	2.2 (2.0)	0.3 (0.8)	4.4	2.7 (2.8)	−5.0 (−4.8)	−5.0 (−4.5)
Belgium	1.0/1.4	−2.3/−0.2	1.3	−1.3 (−0.7)	4.5 (4.4)	1.4 (1.8)	0.4 (0.1)	−0.1 (0.2)
Britain	0.7/0.8	−3.4/−1.3	0.7 (0.6)	−2.6 (−1.7)	3.6 (3.5)	1.0	−2.2 (−2.4)	−1.8 (−2.0)
Canada	−1.1/0.8	−1.7/0.3	0.5 (0.4)	−0.7 nil	2.4 (2.2)	0.9 (1.3)	1.0	−0.6 (−0.7)
France	0.6/0.9	−2.3/−1.1	0.7	−1.7 (−1.0)	2.8 (3.0)	0.7 (1.1)	−1.8	−2.0 (−1.9)
Germany	1.0/1.3	−3.0/−1.8	1.1 (1.0)	−2.5 (−1.4)	2.6	0.5 (0.7)	6.6	5.3 (5.8)
Italy	−0.8/−0.4	−3.1/−1.3	−0.6 (−0.5)	−2.3 (−1.2)	3.3 (3.4)	1.2 (1.6)	−2.8 (−2.9)	−2.3 (−2.7)
Japan	−0.5/0.3	−5.7/−1.4	−0.2 nil	−3.2 (−1.4)	1.4 (1.5)	−0.5 (−0.1)	3.6 (3.8)	3.1 (3.7)
Netherlands	1.0/2.0	−2.3/−0.4	1.8 (1.6)	−1.6 (−0.6)	2.3	0.9 (1.3)	6.9 (6.7)	5.9 (6.0)
Spain	1.0/1.3	−3.0/−1.5	1.1 (1.0)	−2.3 (−1.3)	3.9 (4.3)	0.9 (1.8)	−9.8	−8.1 (−8.0)
Sweden	0.3/1.0	−2.2/0.5	0.6	−1.0 (−0.6)	3.4	0.8 (1.2)	7.3	6.9 (7.0)
Switzerland	1.6/1.9	−1.8/−0.2	1.8 (1.6)	−1.0 (−0.6)	2.3 (2.4)	0.5 (0.8)	8.9 (9.1)	8.7 (9.1)
United States	1.1/1.3	−2.6/−0.9	1.2 (0.9)	−2.0 (−1.2)	3.8 (3.7)	−0.7 nil	−4.6 (−4.5)	−3.2 (−3.1)
Euro area	0.7/1.0	−2.7/−1.1	0.8 (0.7)	−2.1 (−1.4)	3.1 (3.2)	0.8 (1.1)	−0.4 (−0.3)	−0.6 (−0.2)

Sources: ABN AMRO, BNP Paribas, Citigroup, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Scotiabank, UBS



Trade, exchange rates, budget balances and interest rates

Feb 5th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Feb 4th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−833.1 Nov	−697.9 Q3	−4.6	–	–	−3.2	0.36	2.91
Japan	+47.3 Nov	+167.1 Nov	+3.6	89.7	107	−3.1	0.61	1.35
China	+295.1 Dec	+371.8 2007	+10.2	6.83	7.18	−0.1	1.34	3.24
Britain	−178.6 Nov	−45.6 Q3	−2.2	0.69	0.51	−5.3	2.10	3.97
Canada	+47.3 Nov	+19.2 Q3	+1.0	1.23	1.00	0.3	0.84	3.40
Euro area	−52.0 Nov	−88.9 Nov	−0.4	0.78	0.68	−1.7	2.05	3.35
Austria	−1.5 Nov	+16.8 Q3	+3.1	0.78	0.68	−0.9	2.05	4.21
Belgium	+7.9 Sep	−8.2 Sep	+0.4	0.78	0.68	−0.6	2.08	4.31
France	−83.3 Nov	−58.7 Nov	−1.8	0.78	0.68	−3.2	2.05	3.82
Germany	+267.2 Nov	+244.3 Nov	+6.6	0.78	0.68	0.3	2.05	3.36
Greece	−68.5 Oct	−52.6 Nov	−13.3	0.78	0.68	−3.9	2.05	5.69
Italy	−18.7 Nov	−72.2 Oct	−2.8	0.78	0.68	−2.8	2.05	4.51
Netherlands	+55.4 Nov	+67.6 Q3	+6.9	0.78	0.68	1.0	2.05	3.91
Spain	−149.5 Oct	−164.1 Oct	−9.8	0.78	0.68	−3.3	2.05	4.29
Czech Republic	+4.4 Dec	−6.6 Nov	−2.7	21.9	17.5	−1.9	2.67	4.30
Denmark	+6.2 Nov	+6.3 Nov	+1.0	5.78	5.08	3.3	4.50	3.95
Hungary	−0.1 Nov	−11.3 Q3	−5.6	230	179	−3.4	9.48	9.70
Norway	+78.9 Dec	+86.5 Q3	+18.4	6.88	5.50	19.7	3.44	3.72
Poland	−24.0 Nov	−29.4 Nov	−5.6	3.61	2.45	−1.8	4.76	5.52
Russia	+189.4 Nov	+98.9 Q4	+6.0	36.3	24.6	5.5	13.00	10.84
Sweden	+17.2 Dec	+40.5 Q3	+7.3	8.28	6.44	2.4	2.15	3.03
Switzerland	+18.4 Dec	+40.3 Q3	+8.9	1.16	1.10	0.9	0.52	2.01
Turkey	−69.8 Dec	−43.9 Nov	−6.0	1.63	1.18	−1.5	14.02	7.61‡
Australia	−4.0 Dec	−56.7 Q3	−5.0	1.54	1.11	−0.3	3.22	4.31
Hong Kong	−26.0 Dec	+27.1 Q3	+10.0	7.75	7.80	−1.2	0.95	1.60
India	−114.5 Dec	−28.5 Q3	−3.6	48.8	39.5	−6.0	4.78	7.01
Indonesia	+12.1 Nov	+3.9 Q3	+0.4	11,675	9,242	−1.4	10.51	10.56‡
Malaysia	+42.2 Nov	+38.3 Q3	+11.4	3.63	3.23	−5.1	2.58	4.09‡
Pakistan	−21.8 Dec	−15.6 Q3	−5.5	79.2	62.8	−6.8	14.14	23.50‡
Singapore	+18.4 Dec	+29.2 Q3	+17.2	1.51	1.42	0.8	0.56	1.98
South Korea	−12.2 Jan	−6.4 Dec	−2.1	1,379	942	1.7	2.93	5.18
Taiwan	+3.9 Dec	+28.8 Q3	+4.7	33.7	32.0	−1.7	1.15	1.45
Thailand	+0.2 Dec	−0.2 Dec	−0.3	34.9	32.9	−1.4	2.22	2.84
Argentina	+13.2 Dec	+9.0 Q3	+2.7	3.50	3.17	0.2	15.13	na
Brazil	+23.3 Jan	−28.3 Dec	−1.9	2.28	1.76	−0.7	12.66	6.16‡
Chile	+10.2 Dec	−1.6 Q3	−2.5	617	475	4.5	7.08	4.01‡
Colombia	+2.0 Dec	−5.3 Q3	−2.7	2,462	1,928	−1.4	9.56	7.21‡
Mexico	−16.0 Dec	−11.8 Q3	−1.9	14.6	10.8	nil	7.16	7.98
Venezuela	+50.2 Q3	+49.4 Q3	+14.8	5.45	5.25§	−1.1	17.17	6.55‡
Egypt	−25.2 Q3	+0.1 Q3	−0.9	5.56	5.53	−6.8	11.48	4.79‡
Israel	−13.7 Dec	+2.6 Q3	+0.7	4.06	3.63	−1.2	0.86	3.38
Saudi Arabia	+150.8 2007	+95.0 2007	+26.2	3.75	3.75	33.6	1.16	na
South Africa	−10.9 Dec	−23.2 Q3	−7.5	9.93	7.67	0.1	10.85	7.87
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−3.9 Nov	−2.5 Nov	−10.6	12.1	10.7	−1.5	6.93	na
Finland	+10.2 Nov	+6.8 Nov	+3.5	0.78	0.68	4.6	2.01	4.05
Iceland	−0.2 Jan	−5.4 Q3	−17.3	115	66.0	0.3	18.22	na
Ireland	+41.4 Nov	−16.4 Q3	−4.9	0.78	0.68	−6.6	2.05	5.50
Latvia	−5.9 Nov	−4.8 Nov	−14.1	0.55	0.48	−2.7	8.29	na
Lithuania	−7.3 Nov	−6.4 Nov	−13.9	2.68	2.36	−0.9	7.53	na
Luxembourg	−7.5 Oct	+4.0 Q3	na	0.78	0.68	0.1	2.05	na
New Zealand	−3.8 Dec	−11.6 Q3	−9.0	1.95	1.27	−1.0	3.85	4.50
Peru	+4.0 Nov	−3.0 Q3	−3.8	3.24	2.92	2.1	7.00	na
Philippines	−7.5 Nov	+2.9 Sep	+2.6	47.5	40.7	−0.8	5.25	na
Portugal	−34.3 Oct	−29.3 Nov	−11.5	0.78	0.68	−2.4	2.05	4.46
Slovakia	−1.2 Nov	−6.7 Sep	−6.1	23.4	22.8	−2.3	1.35	4.19
Slovenia	−4.7 Nov	−3.4 Oct	−6.3	0.78	0.68	0.4	2.05	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Feb 5th 2009
From The Economist print edition

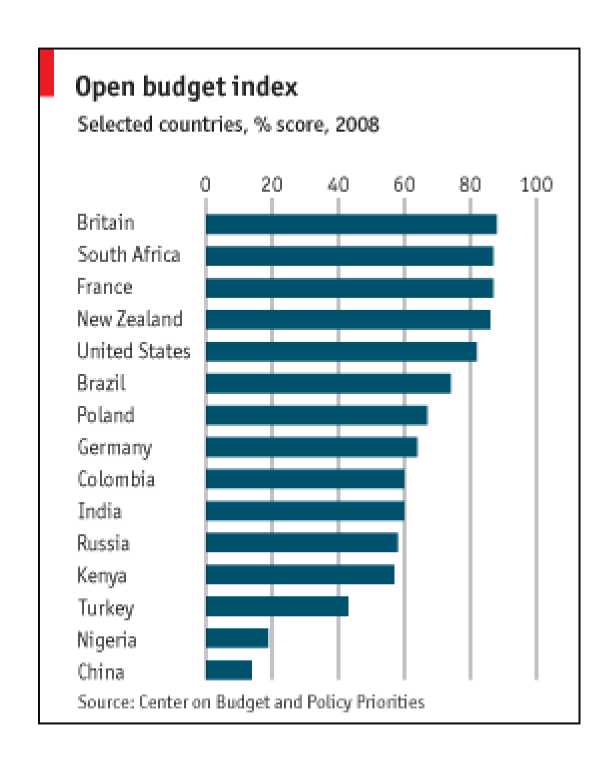
Markets

	Index Feb 4th	% change on one week	% change on Dec 31st 2007 in local currency	% change on Dec 31st 2007 in $ terms
United States (DJIA)	7,956.7	-5.0	-40.0	-40.0
United States (S&P 500)	832.2	-4.8	-43.3	-43.3
United States (NAScomp)	1,515.1	-2.8	-42.9	-42.9
Japan (Nikkei 225)	8,038.9	-0.8	-47.5	-34.6
Japan (Topix)	792.8	-1.4	-46.3	-33.1
China (SSEA)	2,212.9	+5.9	-59.9	-57.2
China (SSEB, $ terms)	130.8	+4.9	-66.5	-64.2
Britain (FTSE 100)	4,228.6	-1.6	-34.5	-52.9
Canada (S&P TSX)	8,693.1	-2.4	-37.2	-48.7
Euro area (FTSE Euro 100)	702.1	-1.0	-48.9	-53.8
Euro area (DJ STOXX 50)	2,297.7	-1.1	-47.8	-52.8
Austria (ATX)	1,738.0	+1.4	-61.5	-65.2
Belgium (Bel 20)	1,906.5	-1.0	-53.8	-58.2
France (CAC 40)	3,069.0	-0.2	-45.3	-50.6
Germany (DAX)*	4,492.8	-0.6	-44.3	-49.6
Greece (Athex Comp)	1,744.1	-0.3	-66.3	-69.5
Italy (S&P/MIB)	18,015.0	-1.8	-53.3	-57.7
Netherlands (AEX)	254.8	-0.9	-50.6	-55.3
Spain (Madrid SE)	901.8	-2.4	-45.1	-50.3
Czech Republic (PX)	749.4	-4.7	-58.7	-63.8
Denmark (OMXCB)	243.1	+2.4	-45.8	-51.0
Hungary (BUX)	11,890.7	-0.3	-54.7	-63.8
Norway (OSEAX)	273.4	-3.3	-52.0	-61.1
Poland (WIG)	23,236.1	-7.2	-58.2	-68.9
Russia (RTS, $ terms)	514.9	-5.8	-69.0	-77.5
Sweden (Aff.Gen)	192.8	+0.2	-43.4	-54.1
Switzerland (SMI)	5,225.5	-3.6	-38.4	-39.1
Turkey (ISE)	26,141.1	-2.1	-52.9	-65.9
Australia (All Ord.)	3,382.3	-1.5	-47.3	-59.9
Hong Kong (Hang Seng)	13,063.9	+3.9	-53.0	-52.8
India (BSE)	9,201.9	-0.6	-54.6	-63.5
Indonesia (JSX)	1,320.4	-0.1	-51.9	-60.1
Malaysia (KLSE)	876.8	-0.3	-39.3	-44.1
Pakistan (KSE)	5,534.3	+7.7	-60.7	-69.3
Singapore (STI)	1,707.4	-3.3	-50.7	-52.7
South Korea (KOSPI)	1,195.4	+3.2	-37.0	-57.1
Taiwan (TWI)	4,390.0	+3.3	-48.4	-50.2
Thailand (SET)	433.0	-3.4	-49.5	-51.3
Argentina (MERV)	1,079.0	-2.4	-49.9	-54.7
Brazil (BVSP)	40,129.0	-0.2	-37.2	-51.2
Chile (IGPA)	12,298.4	+0.8	-12.6	-28.9
Colombia (IGBC)	7,869.2	+2.2	-26.4	-36.9
Mexico (IPC)	19,622.6	-2.6	-33.6	-48.6
Venezuela (IBC)	35,697.9	+1.6	-5.8	-58.1
Egypt (Case 30)	3,548.4	-8.3	-66.1	-66.4
Israel (TA-100)	618.3	+1.7	-46.4	-48.7
Saudi Arabia (Tadawul)	4,794.6	+0.1	-56.6	-56.6
South Africa (JSE AS)	20,639.1	-1.9	-28.7	-50.7
Europe (FTSEurofirst 300)	811.4	+0.1	-46.1	-51.3
World, dev'd (MSCI)	848.0	-3.5	-46.6	-46.6
Emerging markets (MSCI)	536.0	+0.5	-57.0	-57.0
World, all (MSCI)	210.3	-3.1	-47.8	-47.8
World bonds (Citigroup)	776.3	-1.1	+6.3	+6.3
EMBI+ (JPMorgan)	389.8	-1.4	-10.1	-10.1
Hedge funds (HFRX)‡	1,031.7	nil	-22.4	-22.4
Volatility, US (VIX)	43.9	39.7	22.5	(levels)
CDSs, Eur (iTRAXX)†	155.5	+2.1	+207.3	+177.9
CDSs, N Am (CDX)†	219.5	+5.3	+181.8	+181.8
Carbon trading (EU ETS) €	10.5	-11.1	-54.1	-58.5

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡Feb 3rd.

Open budget index

Feb 5th 2009
From The Economist print edition



South Africa is one of handful of countries that provide extensive information about its government's budget, according to the new Open Budget Index, created by the Center on Budget and Policy Priorities, a research outfit. The index is based on a survey of 85 countries, only five of which scored more than 80 points. The scores rise with the clarity, scope and availability of documents on public spending. The average index score was just 39, indicating a low level of transparency—tending to encourage the wasteful and corrupt use of public money. The worst offenders, with scores between zero and 20, are often poor countries. But this group also includes some middle-income countries, such as China and Nigeria.